Raising the Bar: Call for Innovation

With technology constantly evolving and becoming an integral focus of most businesses, the real estate industry needs to be innovative and advance to the next level in solutions

by David W. Stanford

In the late 1980s, RealFoundations began its association with the *JPM* software survey, now in its tenth edition. And while there is no doubt that industry software applications have come a long way with better features and functionality, we should continue to question whether the advances have gone far enough.

Since the first survey was conducted, we have witnessed a significant structural change in the ownership structure and operational models of ever-growing real estate portfolios. In the late 1990s, a burst of innovation in the real estate technology space launched many solutions destined to make our lives less complicated. Now the industry is experiencing an unprecedented flow of capital into the institutional investment sector, which is driving the need for decision making in less time in a higher risk environment.

However, the industry is facing many of the same challenges of years past with fragmented applications, lack of some basic features required to support today's business model, and an ambivalent buyer who settles for non-integrated solutions. Rather than discussing the approach to properly qualify and select a vendor—an approach that hasn't changed much over the years—it seemed more relevant to lay out some key industry trends playing out in the marketplace, and issue a challenge to the software providers and property companies to raise the bar of innovation in relation to what is possible from these property management and accounting solutions.

VENDOR DISCUSSION

The real estate software industry has rapidly evolved over the past few years, presenting a challenging puzzle to managers trying to sort through the various companies, products and presentations. There have been several acquisitions that have confused the market, and we have seen some of the "new economy" providers fade away. In turn, these new dynamics have challenged the software providers to consolidate competing technologies into a cohesive offering for the industry.

While the landscape may be confusing, we are seeing a renewed focus on this market from some of the larger software companies, allowing much needed R&D activity directed at providing better business tools for real estate operators. However, the industry is still lacking suppliers who can deliver a full life-cycle solution to automate many of the processes of a real estate operating company—this should be a primary focus for the next several years.

Now that we have the attention of the software industry, we should start requiring more from vendors and be actively participating in the advancement of their products and solutions to capture a larger share of our process automation needs. As this industry continues to become a commercially accepted investment class, our clients, customers and investors will demand that we require more from the software vendors.

PRODUCT SUMMARY

The transition to Web functionality continues to make good progress across all vendor categories. However, there are still some areas that are lacking Web-based functionality—especially in the forecasting and valuation category—but we are encouraged by the levels of adoption in other areas.

Recently we have seen advances in the ability to model the complex portfolio and partnership structures with the ability to account for the complex equity structures above the property levels. Additionally, we are encouraged by the product focus on leasing workflow and document management features from a few of the participating vendors.

On the downside, there continue to be some basic features related to sales reporting, expense reimbursements, fixed asset accounting and budgeting that have limited functionality, and we don't see enough focus from the providers to "get the basics right." Also, interest in advanced procurement and purchasing solutions has diminished in the minds of the buyer, which is unfortunate in light of growing portfolio size and the ability to leverage this size in purchasing decisions. There continues to be a lot of talk about the elusive "silver bullet" of Business Intelligence, but limited success stories by the mainstream property vendors.

Participating in vendor user groups, attending conferences and beginning a dialogue with vendors is the best way to lobby for the needs of the industry. RealFoundations is committed to advancing the agenda and asks for the functionality that will attain the highest benefits for the real estate community.

PERMANENT STRUCTURAL CHANGES

A "wall of capital" continues to flow into the property industry from many sources, which is accelerating the globalization of the industry. In turn, this creates more sophisticated deal structures and portfolio structures that combine direct equity, debt and securities as assets.

The ability to properly model, account for and consolidate the various structures remains a mainstream requirement largely unmet by the application providers. As we see it, this increased sophistication is here to stay and the providers are being challenged to spend time researching and understanding the market needs in this area, and work with early adopters to develop adequate solutions.

The REIT model continues its global march with the recent activity in Hong Kong, Singapore and Japan, coupled with the expectation of REIT legislation for the United Kingdom and Germany in 2006. From the eyes of a software provider, this creates both opportunity and challenges: an increased market opportunity to sell

...we should start requiring more from vendors and be actively participating in the advancement of their products and solutions...

software that powers the largest REIT industry in the world here in the U.S., along with the additional requirements to support country-specific real estate laws, lease structures, tax authorities and financial reporting needs. To an increasingly transparent and global property investment market, these are now becoming baseline requirements the industry needs from its software suppliers—the message is becoming clear and the stakes are high.

REGULATORY DEMANDS

With the introduction of Sarbanes-Oxley, specifically Section 404 relating to internal controls for public companies, we have witnessed the birth of new compliance processes and demands on both public and private operators of real estate. This has placed new demands on internal IT staffs and accounting groups, as well as software providers.

Unfortunately, more change is on the horizon. It is particularly important to recognize the impact of IFRS, the International Financial Reporting Standards, which is similar to the U.S. GAAP standards for accounting and reporting.

For anyone looking to invest in or to attract capital from foreign countries, take notice: IFRS is the standard across Europe and is rapidly becoming the standard across Asia, most recently China. Additionally, embodied in the Norwalk Agreement is a plan to achieve convergence between the standards by the end of this decade.

For software providers, this creates a whole host of new requirements to comply with revised accounting policies and procedures. The most dramatic impact is the provision of IAS 40 for Investment Property, which is a radical departure from current U.S. GAAP for property presentation on the balance sheet.

The provision introduces the concept of fair value for measurement purposes instead of our normal cost less accumulated depreciation. This single change has implications for basic financial reporting mechanics and, more importantly, moves the property valuation process under the watchful eye of the CFO, which will require more rigor and documentation. The belief is that this will lead to increased M&A activity in the next couple of years as the core property accounting vendors seek to create a fully integrated historical accounting and forecasting footprint.

OPERATIONAL RESPONSES

By working with leading property managers, RealFoundations continues to observe continued expansions of the core role of IT to support the extended property operations, customer processes and revenue activities. Some examples include:

- Providing a 24/7 customer contact center to support facility requests with both live call center agents and Web-based work order input and resolution
- Providing workflow and document automation to assist the commercial leasing process from first contact to lease execution, and tying this into the revenue forecast for quarterly FFO projections

As more operational processes are targeted for automation, new requirements and demands are put on the software providers to develop appropriate solutions. Too often, the void is filled by point solutions with limited integration to the main property management application, which continues the proliferation of the many islands of data inside an organization.

It is RealFoundations' hope that a continued orderly consolidation of the provider market will rationalize the offerings and help customers work within an application rather than leave that work to the IT staff of the operator.

Another rapidly emerging trend that will place increased demands on the core accounting and property management solutions is what we call "Business Process Sourcing." This trend refers to the continued evaluation of what and where specific front and back office processes should be performed and by whom.

We are now seeing movement of certain accounting and support functions to domestic shared service centers and broad interest in "off shoring" certain business processes to increase quality of work and gain cost efficiencies. This results in a much more dispersed work force with additional information providers, and places greater reliance on the application infrastructure the vendors are providing.

LEVERAGING RECENT TECHNOLOGY ADVANCEMENTS

Advancement in general technologies could be better leveraged and put to work by the vendor community in order to run our properties better.

We have seen the tipping point in the acceptance of the hosted application model, which, in our opinion, is a leading practice for this industry. When a company decides to outsource the hosting and technical maintenance of its property and accounting applications, it frees up labor to focus on more service-differentiating activities such as investor reporting and tenant service portals. The vendor community should receive high marks for providing reliable models, educating the buyers and making this a reality.

However, there are a number of generally available technologies that we are woefully behind on incorporating into the daily routines of the applications reviewed in the survey.

A few of these that warrant investigation are:

- Wireless mobility: With the advent of high-speed wireless communication and fast cellular connections, the vendors should focus on application subsets that can leverage this technology.
- XML and data integration: Many other industries have worked hard to adopt data transmission standards that enable data to move between players transparently. We have not seen an appropriate response by the vendor community to seriously consider this movement, which is exacerbated by the lack of interest from the owner community.
- Service-oriented architectures: We are just now seeing the first instances of SOA-based components and .Net functionality. Imagine kicking off a portfolio valuation process from your asset management system and it does the following: consumes services to take actual numbers from your accounting system; updates the budget from the leasing application based on what is happening in the field; kicks off the valuation application to crunch the numbers and provide the summarized pro forma cash flows; and then values back in your asset management system, all without complex manual integration processes. This is now possible and we should be encouraging our providers to invest in this type of technology leverage.

LOOKING FORWARD

Over the past ten years, providers have been rising to the call for better and more sophisticated applications that address the core accounting and lease administration functions within the real estate community. This challenge is well on the way to being solved. However, the themes for the next 10 years are portfolio tools—in contrast to asset level tools of the past 10 years—and globalization.

The current offerings of this generation have focused largely on accounting for and managing individual assets in a single-nationality environment. As discussed above, multiple investment classes on a larger and global scale should help to define and drive the real estate software provider's product strategy and direction going forward.

RealFoundations recognizes the accomplishments of the software community in serving the market as it has existed and have used this forum to issue a specific challenge for vendors to continue listening to the industry and become a partner in its continued growth and globalization. □

David W. Stanford is executive managing director of RealFoundations, a full-service management consultancy focused exclusively on companies in the real estate industry and the real estate function of large corporations.