How do you Benchmark your Real Estate Cost?

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So, what is your real estate metric and what does that even mean? It is important for each of us to understand that real estate costs play a role in our personal and our business lives. This is true regardless of whether we are a renter, a home owner, an employee or a business manager.

Individual Housing Costs

It is easiest to begin to understand the concept by making it personal. How much of our salary would you commit to rent, or a mortgage payment? It varies by location, but in most cases, people are advised to keep their housing cost at 30 percent or less of their after-tax salary. Anything above this, means you won't have money for food, savings or other expenses. Likewise, when you want to borrow money to buy an apartment, bankers will be looking at a similar formula which tries to determine if you have the ability to make your monthly payments based on your salary and any other major expenses you have.

Business Occupancy costs

Likewise, businesses have a set of basic cost categories or metrics they need to be watching. If they are a service sector company, the largest costs are generally salaries and then real estate costs, the latter often referred to as occupancy costs. If a company is in manufacturing, additional costs on the list including equipment and materials, but occupancy costs are still important. As a business manager, it is important to make sure occupancy costs stay within their assigned cost metric, especially as other costs rise. As an employee it is important to understand that how a company manages their real estate costs, may impact your salary.

Over the past five years in surveys done by the American Chamber of Commerce in China (AmCham) of member companies have found a few of their top concerns include rising salary costs and rising social taxes. Additionally, a number of companies including a Korean cell phone maker have moved operations to Vietnam, reportedly due to cheaper labor costs. In this case, rising labor costs were a major metric driving this company to another location. However, if you were an employee at a firm looking for a raise, it is important to understand what other pressures your company has and if they are facing rising costs for materials and rents, they are going to be less able to pay higher salaries. Even more importantly, if they get the occupancy cost wrong, that might be the end of the business.

So keep in mind, if you are feeling squeezed by your costs increasing and you are looking to your boss to give you a raise to help solve your problems, she may be balancing the same equation about how to balance rising rental costs or material costs with salary costs.

Office costs and upgrading options

Since many service sector firms spend nearly half of their revenues on staff salaries and related costs they are often only able to allocate 10 to 15% of revenue for rents (this also varies widely by specific company type and office layout). However, in the past few years, with the Tianjin market seeing high levels of new office supply and high vacancy levels, rents have fallen or stagnated. This has created the opportunity for companies to upgrade their space. Why stay in an old poorly maintained building for example when a nicer or better maintained one is available for around the same rent as your current space? In this case, office premises can be improved without impacting occupancy costs and business managers should take advantage of this opportunity. At present high vacancy rates mean that in almost all locations across the city, new or well-maintained office space can be obtained at the same rents one pays for Grade B and Grace C office locations.

Retail rents

For companies looking to rent retail space, trying to figure out the correct metric can be more complicated. Retail rents can be charged as a single flat monthly fee, or as a percentage of sales, or they might be a base rate plus a percentage of sales. So how much of their sales should a retailer be paying in rent or in this case as a rough estimate of occupancy cost? It varies by retail type, by location and by country. The chart below is an example, I've used India, a developing country as a proxy for China since Chinese numbers are often not as readily available.

Retail Occupancy Cost Ranges (% of sales paid in rent)		
	India	USA
Bookstores	7-11%	3-4%
Clothing & accessories	10-16%	7%
Electronics Stores	2-4%	2-3%
Fast food	5-8%	3-4%
Furniture	5-8%	5-6%
Health & Personal Goods	4-8%	3-4%
Restaurants	11-18%	5-6%

Source: India Retail and Real Estate Performance Study at asipac.com, yourbusiness.azcentral.com

So why do the numbers in the USA, versus India vary and, in some cases, widely? The India numbers are in my experience closer to the expense ratios in China, which in some cases I've seen rise even as high as 25-30% of sales for some key locations and retail types. There are a couple reasons for the variances. First, labor costs in developed markets are more expensive, so in full-service restaurants especially, higher labor costs mean retailers need to keep their rent levels lower. Additionally, in developed markets, market practice results in most sales actually being recorded whereas in developing markets more goods tend to be sold "off the books" meaning the tenant is selling more than they are telling the landlord or the tax authority. Landlords realize this and so charge a rent that looks substantially higher in terms of percentage of 'reported sales." With retailers struggling in some cases, it is important to be precise about what rents are reasonable and which other costs can be maintained or where other efficiencies can be found.

Summary

So, whether you are an individual or a business manager, it is important to keep a watch on how much you spend on occupancy costs. If you are a young employee, it is important to have a rent that allows you to save and plan for other rising costs. If you run a service sector firm, Tianjin currently offers plenty of opportunities to upgrade at little or no additional cost thanks to high vacancy rates across the city. If you run a retail business it is important to find the specific benchmarks for your industry sector and make sure you are staying within those ranges in order to be able to maintain good salary levels and profit margins and not overpay for an "ideal" location. And if you are working with partners from different countries, it is worth reviewing if your base metrics vary widely and if so, what sort of adjustments should you make or consider in your target market because getting your occupancy cost wrong, could endanger your entire business plan.

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