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# The Tenant as a Customer: can good service improve real estate performance?

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## Abstract

Customer Relationship Management (CRM) theory suggests that good customer service results in satisfied customers, who in turn are more likely to remain loyal and recommend the service provider to others. Proponents of good customer service for tenants claim that landlords should see a return on any investment in their customer service, in the form of enhanced real estate performance.<sup>2</sup> This paper begins by reviewing research on customer service returns in other industries. Through consideration of the characteristics of real estate markets, the paper explains how factors such as (*inter alia*) lease terms, property market cycles, and property type, might determine the relationship between customer service and real estate performance. The paper concludes that further research is needed to isolate specific aspects of customer service that are most appreciated by customers. It suggests that the financial returns which accrue to landlords adopting a customer-focused approach might indeed be quantified, and suggests an appropriate method for such future research.

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<sup>2</sup> Net rental income and capital appreciation

## 1. Introduction

Traditionally there has been a somewhat adversarial relationship between landlords and tenants. Adam Smith (1776 p124) believed that rent had a “natural” level, which would maximise the benefit to the landlord, with lease terms being set so as to give the tenant the smallest viable tract of land for the maximum price the tenant could afford to pay. Until the late 20<sup>th</sup> century, property management continued to be about maximising rents and rapid recourse to legal process to resolve disputes between landlord and tenant. Edington (1997) points out that the traditional approach to property management “gives no glimpse of the notion that if a supplier (the landlord) is receiving substantial sums (rents) from the customer (tenant), then the customer has the right to receive exemplary service”. Edington was an early proponent of the need for customer-focused property management, eschewing the “old way” of treating customers as a source of “upwardly mobile income” and recognizing instead that “it is the tenants that are mobile and that their custom must be earned.”

Other real estate practitioners and writers have recognised that historically the real estate industry has not focused enough on customer relationships (Silver, 2000; Valley, 2001). During the past decade there has been a gradual shift in attitude and behaviour on the part of property owners and managing agents towards a more customer-oriented approach to property management. Many landlords and managing agents acknowledge that describing occupiers as “customers” rather than “tenants” creates more of a partnership and a mutually beneficial, respectful relationship (Kivlehan, 2011). Some dissenters, however, indicate that what matters are actions rather than words, and that there is a risk that landlords may think that they will improve the relationship simply by calling their tenants “customers”.

Since “customer satisfaction” is not shown on the balance sheet of a company, other ways to quantify its impact are required when predicting future performance. Intuitively one would expect that treating the tenant as a valued customer, employing efficient, customer-centric processes and staff and providing good value-for-money for occupiers, ought to enhance the value of a property through increased demand and fewer void periods. As their satisfaction increases, occupiers should be more likely to remain loyal to their property owner or managing agent and to recommend them to other potential occupiers, thus enhancing the landlord’s reputation, building their brand and increasing their profitability.

This paper considers management theory and research evidence to examine the relationship between customer service, customer satisfaction and the financial performance of organisations in general, and real estate in particular. Determinants of customer service quality are examined with the aim of subsequently researching the impact of each on property performance.

Since the purpose of this research is to focus on the benefits to landlords and tenants of good customer service, it would be preferable to refer to tenants as “customers” throughout this paper; however, the term “customer” can be ambiguous, and could cause confusion between, say, retail tenants and shoppers, for example. So, for the sake of clarity, tenants will generally be referred to as “occupiers” and landlords as “property owners”, except where the traditional roles are alluded to.

An indication of a company's attitude towards customer service may be found from its website, annual report and other company publications. An assessment of the evolution of customer focus in the property industry in Sweden found that half of the Commercial Real Estate Companies whose Annual Reports were analysed for evidence of commitment to customer-related actions and intentions were deemed to "espouse customer-orientation" (Palm, 2011). A larger study, commissioned by The European Public Real Estate Association (EPRA), measured evidence of customer-focus in published statements from the top 50 European publicly listed property companies and concluded that "86% have embraced the customer (tenant) focused approach to property ownership and management to some degree" (Real Service, 2012). But what, exactly, is meant by delivering excellent customer service?

## 2. Customer service and Customer Satisfaction

Many attempts have been made to define quality in customer service, and the consensus is that excellent customer service cannot be defined in absolute terms; rather it is a function of the performance of the supplier and the expectation of the customer. In manufacturing, a common definition of quality is “Conformance to Requirements” with a performance standard of zero defects (Crosby, 1979). This idea can be applied to real estate when considering the functionality of the building and whether it meets the needs of the occupier, but is harder to apply to property *management* performance.

### **The SERVQUAL Model and Derivatives**

Extensive work on assessing, defining and modelling quality in service encounters has been carried out by Parasuraman et al, who devised the SERVQUAL model of determinants of service quality (Parasuraman, Zeithaml, & Berry, 1985). Guided by earlier work (Darby & Karni, 1973; Kano, Nobuhiku, Fumio, & Shinichi, 1984; P. Nelson, 1974), Parasuraman built on Nelson’s ‘search properties’<sup>3</sup> and ‘experience properties’<sup>4</sup>, and Darby and Karni’s ‘credence properties’<sup>5</sup> to create a framework for measuring service quality based upon gaps in perception between supplier and customer. The original model included ten determinants of service quality: Access, Communication, Competence, Courtesy, Credibility, Reliability, Responsiveness, Security, Tangibles and Understanding (Parasuraman et al., 1985). These were later condensed into five dimensions: Tangibles (physical facilities, equipment and appearance of personnel), Reliability (ability to perform the promised service dependably and accurately), Responsiveness (willingness to help customers and provide prompt service), Assurance (knowledge and courtesy of employees and their ability to inspire trust and confidence), and Empathy (caring individualized attention the firm provides its customers (Parasuraman, Zeithaml, & Berry, 1988). The researchers’ premise was that customer satisfaction with service quality depends not only on the performance of the service but also on the customer’s prior expectation, which in turn is influenced by recommendation by others (word of mouth), personal needs and past experience, and which will alter over time (Omachonu, Johnson, & Onyeaso, 2008).

The SERVQUAL framework has been cited and adapted by numerous other researchers – one academic database<sup>6</sup> alone gives 2000 “hits” for SERVQUAL. Many other writers agree that service quality is a function of performance and expectation (Gee, Coates, & Nicholson, 2008; Grönroos, 1982; Lewis & Booms, 1983; Reichheld & Sasser Jr, 1990; Sivadas & Baker-Prewitt, 2000) and is judged by customers not only on technical quality (the outcome) but also functional quality (the delivery process) (Ennew, Reed, & Binks, 1993). The SERVQUAL model has been applied to a variety of industries, although the dimensions which should be used depend upon the type of services offered by an organisation.

An alternative approach is to measure perceived quality alone, without needing to know the customer’s prior expectation and whether disconfirmation affects results (Cronin Jr & Taylor, 1992). This has been debated in the academic journals (Cronin Jr & Taylor, 1994; Parasuraman, Zeithaml, & Berry, 1994) and the consensus is that measuring both the *expectations* and the *perceptions* of customers does provide some extra information. In particular customer expectation has been found empirically to ‘Granger-cause’<sup>7</sup> customer perceived quality and customer satisfaction (Granger,

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<sup>3</sup> Attributes that can be evaluated prior to purchasing a product

<sup>4</sup> Attributes that can be assessed only after purchase or during consumption

<sup>5</sup> Attributes that cannot be evaluated but must be taken on trust

<sup>6</sup> Emerald

<sup>7</sup> Granger-causality involves testing statistically the hypothesis that a variable depends upon lagged i.e. past values of another variable

1969; Omachonu et al., 2008). However the benefit of measuring both expectation and perception has to be offset against the increased complexity of analysis and the reduced likelihood of customers completing a longer questionnaire.

An even more parsimonious approach is taken by Reichheld (2003a, 2006; Reichheld & Teal, 1996) who devised the Net Promoter Score (NPS)<sup>8</sup>, based on responses to the single question “How likely is it that you would recommend this company to a friend or colleague?” Another single-question metric, the Customer Effort Score (CES), (Dixon, Freeman, & Toman, 2010), asks, “How much effort did you personally have to put forth to handle your request?” Each approach, NPS, CES and conventional customer satisfaction questionnaires, has its advantages and disadvantages, including the fact that respondents may not actually do as they say, and that poor scores on NPS or CES may not help a company determine specific causes of dissatisfaction.

Variants of SERVQUAL have been devised for real estate service quality measurement. RESERV is a model designed to measure satisfaction with Real Estate Brokerage i.e. residential estate agency service (S. L. Nelson & Nelson, 1995). It uses the five dimensions of SERVQUAL plus an additional two: Professionalism and Availability. SERVPERF is a variant of SERVQUAL which focuses on perception of performance (Cronin Jr & Taylor, 1992). Other dimensions used in various models include Credibility, Security, Competence, Accessibility, Communication, Understanding, Courtesy, Consulting, Price, Offering, Clout and Geographics in addition to - or as variants of - SERVQUAL’s five dimensions (Van Ree, 2009; Westbrook & Peterson, 1998). PROPERTYQUAL is a model designed to investigate occupier satisfaction with purpose-built office buildings, and uses SERVQUAL’s five dimensions plus some property-specific ones: Cleanliness, Building services, Signage, Security, Parking and Building Aesthetics (Baharum, Nawawi, & Saat, 2009).

### **Other Methods of Determining Customer Satisfaction**

SERVQUAL-style questionnaires are the most widely used method of measuring customer satisfaction, but there are other approaches involving, for example, interviews, focus groups, and seeking feedback by eliciting complaints and compliments. The American Customer Satisfaction Index (ACSI)<sup>9</sup> (Fornell, 2001, 2007) uses a combination of interview feedback and econometric modelling of perception and expectation ratings to quantify customer satisfaction. Satisfaction Scores are calculated for individual companies or organisations and then using statistical techniques these are combined to give an overall national figure.

The Institute of Customer Service consulted 153 senior executives to gather their views on determinants of customer satisfaction (ICS, 2011) and the most important were considered to be:

1. Understanding the Customer's Viewpoint
2. Gathering and Acting on Customer Feedback
3. Training and Development of Staff in Soft Skills
4. Selecting the Right Staff
5. Being Responsive in terms of Quality
6. Empowering Staff
7. Being Responsive in terms of Speed

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<sup>8</sup> The Net Promoter Score is designed to predict whether a business will grow (Reichheld, 2003b, 2006; Reichheld & Teal, 1996). Customers rate the likelihood that they would recommend the company (or its product or service) to others.

Those that give a score of 0 – 6 are considered “detractors”; 7 – 8 is neutral or passive whilst “promoters” are the customers who rate their likelihood to recommend 9 – 10. NPS is calculated by subtracting the percentage of detractors from the percentage of promoters.

<sup>9</sup> ACSI was launched in 1994 and was based on the earlier Swedish Customer Satisfaction Index, conceived in 1987

In the UK property industry, the findings from focus groups have provided guidance to help property owners and managers achieve customer satisfaction. Regular tenant-association meetings are held at many multi-occupancy buildings and estates, allowing occupiers and property managers to share opinions and discuss issues. Findings from such discussions between occupiers and managers enabled Edington (1997) to create a framework to help real estate organisations become more customer-centric. The steps involve:

- Defining the Customer
- Researching what the customer wants
- Creating a Mission for the Organisation
- Leadership, Empowerment, Training and Communication
- Process Improvement and information management
- Measuring success and benchmarking

The Real Service Best Practice Group uses a similar approach to defining best practice in property ownership and management, with building blocks encompassing *Service strategy, Customer Solutions, People and Leadership, Supply Chain Management, Operations and Measurement*. The validity of the framework is then assessed using customer satisfaction questionnaires. Such an approach is used, too, by the Property Industry Alliance and CORENET GLOBAL UK in annual surveys to assess the satisfaction of occupiers of UK Commercial Property (“UK Occupier Satisfaction Index 2007-2012,” 2012). The OSI questionnaire asks occupiers about their satisfaction with the following aspects of their tenure:

1. Availability of commercial property of the right size and location
2. Flexibility of leases within the UK, in terms of lease length and the ability to break
3. Flexibility of leases within the UK, in terms of the ability to assign and sub-let
4. Availability of the desired lease terms at an acceptable price
5. Property industry understanding of business needs
6. Being treated as a valued customer by the property industry
7. Communication
8. Responsiveness to requests for service
9. Facilities services
10. Value for money - service charge
11. Timeliness of service charge management information
12. Quality of service provided by property advisors, lawyers and other professionals
13. Progress the UK property industry has shown in environmental initiatives
14. Availability of information on the environmental performance of the building
15. Compliance with the Code of Practice for Commercial Leases
16. Compliance with the RICS Code of Practice for Service Charges
17. Overall satisfaction as an occupier
18. Change in overall satisfaction as a customer of the UK property industry over the past three years
19. Relationship with the UK property industry compared with other business to business relationships
20. Overall value for money

All methods of assessing customer satisfaction suffer from potential flaws, including the subjective nature of satisfaction, the extent to which a sample of respondents is representative of the population and the risk that respondents may give answers that they think the interviewers want to hear. For example, several studies have been conducted into the impact of “Service with a Smile” on Customer Satisfaction (Barger & Grandee, 2006; Clark, 2012). The scores given by customers rating *facilities* were found to be much higher when staff smiled at customers or merely wore a smiley badge whilst not actually smiling themselves. This study claimed to show that customers’ perception of a product or service is increased by smiling. However, the results could be interpreted as showing that customers did not want to criticise facilities when they felt that staff were making an effort,

even though their actual perception may have been unchanged. Other studies of the effects of smiling have been conducted, including one which found that smiling waitresses earn more in tips (Tidd & Lockard, 1978), but again this could be interpreted as customers showing empathy for a waitress who was evidently trying hard and is not necessarily proof of increased satisfaction.

There are other issues with Likert-style<sup>10</sup> subjective scoring questionnaires, including that respondents are invariably busy and may not answer with due care and attention but may recall a recent incident, for example, and base replies on their perception of that one situation. Also, if prior expectations are not taken into account, different respondents will have a different opinion of the meaning attached to a particular number on the scale. This may not matter if the sample is very large, but may distort results for small samples.

To summarise literature on customer service in the property industry, a variety of approaches have been used to ascertain the quality of customer service and its impact on customer satisfaction. Some researchers apply a variant of SERVQUAL and measure prior expectations as well as satisfaction with aspects of customer service i.e. “determinants of service quality”. This approach helps researchers understand the basis for scores, since the Likert-scale is subjective and one person’s ‘7’ could be another’s ‘5’, depending upon how good they had expected that aspect of service quality to be. This additional information is, however, at the expense of a more unwieldy questionnaire. Other researchers use only perceptions of service quality, and such an approach has been found to provide most, but not all, of the information obtained from studies which also ask about prior expectations. The advantage of this approach is a more parsimonious questionnaire, which is likely to achieve a higher response rate.

The broad consensus amongst the differing methods of assessment is that occupier satisfaction depends upon property owners and managers behaving professionally, being empathetic to the needs of occupiers and empowered to deal promptly and effectively with requests. In addition to the prerequisites of giving good value-for-money and showing flexibility, the importance of good communication and a good relationship with occupiers is evident from research on customer service quality. This is examined in the following section.

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<sup>10</sup> Likert-scoring involves giving a subjective rating on a numerical scale to indicate the extent to which one agrees or disagrees with the question

### 3. Relationship Marketing, Retention, Recommendation and Reputation

#### **The Importance of Customers**

“Relationship Marketing<sup>11</sup>” emphasises the enduring nature of an organisation’s partnership with its customers, recognising that the sale continues after the contract has been signed (Levitt, 1983a), and “the greater the level of satisfaction with the relationship – not just the product or service – then the greater the likelihood that the customer will stay” (Payne, Martin, Clark, & Peck, 1995). The term “Relationship Marketing” has more recently been replaced by the broader concept of Customer Relationship Management (CRM) - “the values and strategies of Relationship Marketing – with particular emphasis on customer relationships – turned into practical application” (Gummesson, 2002).

It may be insufficient merely to *satisfy* customers; rather organisations should endeavour to *delight* them according to Berman (2005) who posits a positive correlation between delight (“a positive surprise beyond their expectations”) and achieving cost savings as a result of “increased word-of-mouth promotion, lower selling and advertising costs, lower customer acquisition costs, higher revenues due to higher initial and repeat sales, and long-term strategic advantages due to increased brand equity and increased ability to withstand new entrants.” Satisfaction is said to be transient whereas delight is more long-term and more decisive in building loyalty; loyalty has been found to be significantly higher amongst ‘delighted’ customers who rate their satisfaction ‘excellent’ than for those who are merely ‘satisfied’ (Heskett, Sasser, & Schlesinger, 1997; Timothy L Keiningham, Goddard, Vavra, & Andrew, 1999; Kingsley Associates, 2004)

The evolution of customer loyalty is examined by Oliver (1999), who proposes a four-stage model from Cognitive Loyalty (believing one brand to be preferable to another), Affective Loyalty (“cumulative satisfying encounters” developing the customer’s attitude), Conative Loyalty (behavioural intention to re-purchase) and Action Loyalty (a commitment to action even in the face of obstacles such as courting by rival suppliers). Even the last stage is vulnerable to factors such as deteriorating performance or unavailability of supply.

#### **Deciding which aspects of Customer Service to Target**

Some aspects of customer service affect customers’ appreciation and loyalty more than others, and organisations should focus on those aspects where customers perceive deficiencies or those which have most impact (Fornell, 2007; Vavra, 2002). A widely used method of categorising the components of customer service according to the impact they have on customers is by drawing a grid with four quadrants. Such grids, in the context of customer service and customer satisfaction, were first described by Martilla and James (1977). Organisations should concentrate on improving service quality in those aspects of customer service in the bottom right sector of the grid, since these are the ones perceived by customers to be of the greatest importance *and* which offer scope for improved performance (Figure 1).

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<sup>11</sup> See, for example, Berry, Shostack, & Upah (1983; Sheth (2002), Grönroos (1978, 1990), Gummesson (2002), and Levitt (1983a)

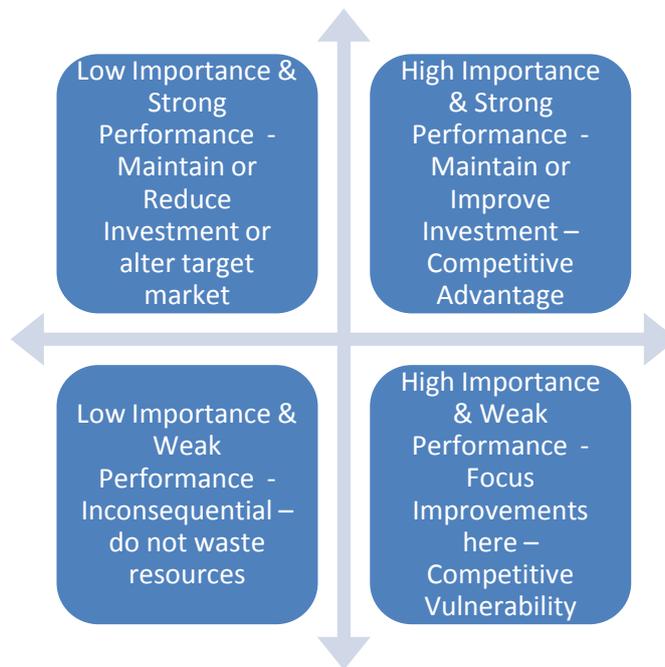


Figure 1: A Generic Importance-Performance Grid, adapted from (Fornell, 2007)

### Customer Relationships and Profit

Relationship marketing and customer relationship management are founded upon the premise that there is a link between customer service, customer satisfaction, customer loyalty and the reputation of a company or brand; research has indeed found such links (Bolton & Drew, 1991; Gale, 1992; T L Keiningham, Goddard, Vavra, & Iaci, 1999; Rust & Zahorik, 1993; Rust, Zahorik, & Keiningham, 1994; Williams & Naumann, 2011; Zeithaml, Berry, & Parasuraman, 1996).

From the 1970s, the PIMS programme (profit impact of market strategy) was established to try to identify the factors associated with differences in performance of business units, and to quantify the return on investment in these factors, which included market share, relative product quality, labour productivity and the rate of growth of the market served by the business unit. The researchers calculated that these factors explained about 40% of the variance in ROI for the business units in the database (Buzzell & Gale, 1987), and quality improvements were found to increase market share as well as selling prices (Phillips, Chang, & Buzzell, 1983). Some studies have criticised or refuted PIMS' findings on the grounds that "failure to control for unobservable factors influencing profitability both biases and exaggerates the effect of strategic factors" (Jacobson, 1990; Jacobson & Aaker, 1987). Gummesson (2004) also concedes that PIMS had some difficulty quantifying cause and effect, but believes that such a task is almost impossible because of the "myriad factors and influences in marketing".

Quantifying the benefits of relationship marketing in real estate is difficult too. Property performance depends upon many factors, including the property itself, its location, age and state of repair, its specification and amenities as well as the way it is managed. "Controlling for confounding factors, randomness and time-varying risk preferences presents major challenges in estimating whether there are statistically significant differences between property asset managers in terms of income and capital growth" (McAllister, 2012a). This makes it difficult, but not impossible, to attribute improved performance to a particular factor.

## 4. The Service – Profit Chain applied to Real Estate

The mechanisms by which excellence in customer service affects profit are considered to be through increased loyalty of customers, turning customers into advocates who recommend the service company through word-of-mouth or public compliments and through enhanced reputation (T. Keiningham, Perkins-munn, & Evans, 2003; Timothy L Keiningham et al., 1999; Rust et al., 1994; Söderlund & Vilgon, 1999). This concept is known as the “service-profit chain” and the idea has been applied to real estate by Edington, who adapts a “marketeer’s representation of customer service, the ‘ladder of loyalty’” to form a ladder of retention showing the stages and activities involved in converting a prospective occupier into an advocate or “magnet occupier” and the rewards to the property owner (Edington, 1997).

Figure 2 shows a conceptual framework for the interactions between occupiers and landlords, and indicates how customer service quality, customer satisfaction, loyalty and advocacy could affect the performance of a property and the profitability of a real estate company. The framework considers the decisions that an occupier makes in renting commercial space in three main stages:

### **Stage 1: Initial leasing process, which influences whether or not the occupier decides to rent a particular property**

Initially, a potential tenant wishes to rent office, retail, industrial or other business space and has preliminary discussions with Landlord X (typically via their leasing agent). The potential occupier may have approached the landlord for a number of reasons, including learning of the availability of a desirable property with an appropriate specification, in a convenient location at a fair price. Such reasons have little to do with customer service, although the reputation of the landlord or a prior relationship might affect whether a potential occupier makes that initial enquiry. The subsequent step, whether or not the lease gets signed, is, however, likely to be affected by the customer’s satisfaction with the leasing process.

### **Stage 2: Occupancy until lease break or expiry, at which time the occupier decides whether or not to renew the lease**

Once an occupier has moved in to the premises, s/he will have contact with the owner or agent, and customer satisfaction with that relationship may influence whether or not the occupier renews the lease at lease-break or expiry. A satisfied occupier is more likely to remain, whereas an occupier who is dissatisfied with the service s/he has received during tenure is less likely to renew the lease.

### **Stage 3: Advocacy and recommendation (or dissatisfaction and detraction) – the opinions expressed by occupiers to acquaintances and the wider world, which contribute to the landlord’s or managing agent’s reputation, and may affect the decisions of other potential occupiers**

An occupier who is satisfied with the relationship and service received may recommend the landlord or agent to other associates seeking to rent premises. In this way, good customer service could help to minimise voids, and a landlord with a good reputation may be able to charge a rental premium. Conversely, an unhappy occupier may spread negative messages about the landlord, leading to more of the landlord’s properties remaining un-let (an increased void rate). Profit should be inversely proportional to the void rate (assuming the rent paid by the new tenant is not higher than that paid by the previous tenant). Also a landlord may have to offer an incentive such as a rent-free period or other inducement to attract a new tenant, and this reduces net rental income. Even when a property is empty, if landlords outsource property management they would generally have to pay a retainer to the managing agent. Additionally, voids may start a downward spiral, particularly in a retail environment where empty units deter shoppers thus reducing footfall and profits for other retailers.

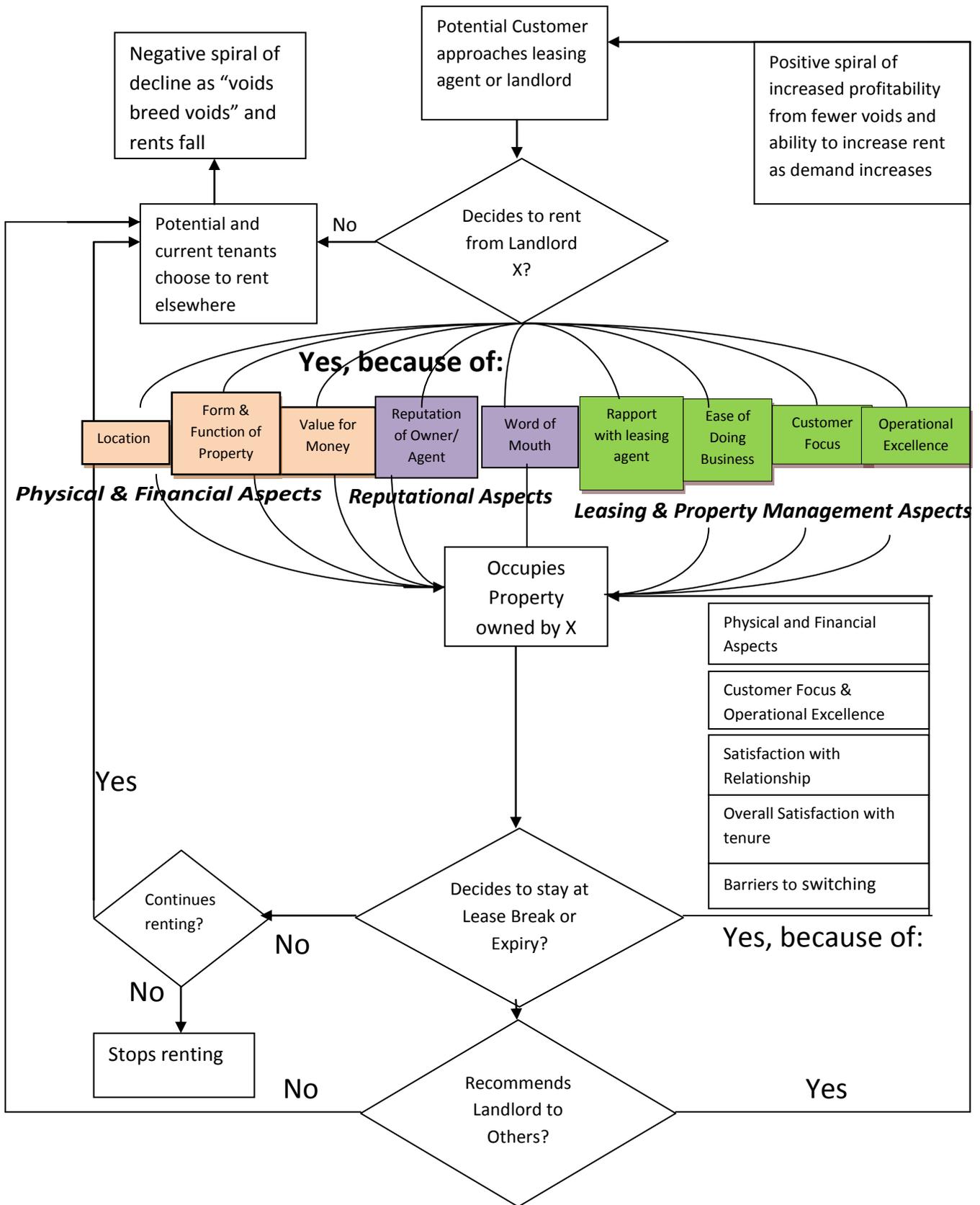


Figure 2: Conceptual Framework positing links between customer service & property performance

The three stages of the framework are discussed in Sections 4.1 – 4.3.

#### 4.1 Stage 1: Initial Leasing Process: factors influencing a customer's decision to sign a lease

Potential occupiers will be interested in a property for many reasons, including its location, functionality, image, sustainability credentials, a prior relationship with property owner or manager and the value for money it represents (Appel-Meulenbroek, 2008; Leishman, Orr, & Pellegrini-Masini, 2011; Roulac, 2007). Factors affecting whether the lease gets signed are likely to include the empathy and professionalism of the leasing agent and the property management services which will be supplied. Most research which has been carried out into customer service in real estate leasing has focused on residential real estate brokerage, although the findings should have implications for reducing void rates in retail, office or industrial real estate by improving the leasing process for commercial property.

Variants of SERVQUAL have been used to investigate the relationship between customer service, customer satisfaction and word-of-mouth recommendation to other potential home-buyers of the real estate broker (Seiler, Seiler, Arndt, Newell, & Webb, 2010). The following questionnaire was found to be a useful way to assess customer satisfaction as measured by their stated likelihood to recommend a real estate broker or to use their services again:

1. Real estate firms should use up-to-date technology.
2. The commission of fee charged should be in keeping with services provided.
3. Properties should be well advertised by real estate firms.
4. Real estate agents should get adequate support from their firms to do their jobs well.
5. A firm's agents should be knowledgeable.
6. Real estate agents should be instrumental in setting the best selling prices for a house.
7. Real estate agents should make suggestions for how to best prepare a house for sale.

Service quality attributes for a One-Dimension Professionalism Scale (Seiler et al., 2010)

#### ***Innovative, Flexible and Straightforward Leases***

Historically leases on commercial property in the UK were for 25 years, with upwards-only rent reviews every five years; the average lease length in 2011 had fallen to just 4.8 years “measured on an equally weighted basis and including the first break where applicable” (BPF, 2012; BPF & IPD, 2012). Occupiers are unwilling to commit to long leases; by offering lease flexibility, owners and managers can demonstrate their understanding of occupiers' needs. An example is to allow small retailers to take a retail merchandising unit (RMU) – a “barrow” or stall – in shopping centres (Morgan & Sanderson, 2009). This has many advantages for all stakeholders: varying the retail mix increases footfall to the Centre, start-up retailers get the opportunity to sell without the commitments and expenditure associated with a conventional lease, service charges can be spread amongst more retailers thereby reducing costs for existing retailers in the Centre, and increasing rental income for the owners and investors. A further benefit can accrue because RMU vendors may subsequently progress to taking a conventional lease once they have tested the market. A similar approach can be taken with other types of commercial property, for example business clubs which enable members to rent office space by the hour.

Another strategy to increase the likelihood of a potential occupier signing the lease on a property is to keep the lease terms as simple as possible, reducing the effort required by the potential occupier, since “customer effort score” has been shown to have a strong inverse correlation with customer satisfaction and loyalty (Dixon et al., 2010). The RICS has recently launched a new type of lease in conjunction with the British Retail Consortium, written in plain English and designed to be straightforward to understand, and offer increased flexibility to occupiers and to help fill retail voids

to benefit landlords (RICS & BRC, 2012). Other major landlords had previously taken the initiative and introduced simplified leases, for example Land Securities' Clearlet Lease (Land Securities, n.d.), which complies with the Lease Code and Service Charge Code and offers customers options such as all-inclusive service charges, so they can better expenditure on their property. However, little research has been carried out to assess the impact of Clearlet-type leases and pro-active lease flexibility on the part of landlords and the extent to which these strategies reduce the length of time a property is vacant.

### ***The Impact of Eco-Certification***

A customer may consider the sustainability credentials of a property when deciding to take a lease. A 'Green Lease' should "encourage landlords to compete for tenants by designing, building and managing sustainable buildings without sacrificing comfort or service while maximising the landlord's return on investment" (Whitson, 2006). Increasingly, companies such as Marks & Spencer are signing 'memoranda of understanding' and green leases which facilitate collaboration between owner and occupier in promoting sustainable buildings, and which should act as a catalyst for closer relationships in other areas<sup>12</sup>. From an occupier's perspective, renting a more efficient building may reduce energy costs and can help the occupier meet carbon reduction commitments and other CSR objectives. Other financial advantages include the possibility of attracting investors who adhere to ethical investment policies, and the avoidance of certain penalties such as environmental taxes. Of course these things will only play a part in determining rent if they are discussed during lease negotiations, yet, ironically, the information in an Energy Performance Certificate is typically disclosed to potential occupiers only *after* heads of terms have been agreed (Fuerst, McAllister, & Ekeowa, 2011). This seems certain to change in the UK, not simply to allow property owners to promote more emphatically the "green credentials" of their buildings, but, more importantly, because the UK Energy Act 2011 will make it illegal to let property with a low EPC rating unless the maximum package of Green Deal measures has been implemented<sup>13</sup>.

During the past decade a number of studies have been carried out to see whether the theoretical advantages to owner and occupier of sustainability certification are being realised. Most of the research indicates that eco-certified properties can command a rental premium and that occupiers are willing to pay more because their operating costs are reduced (assuming either that they pay their own utility bills or that energy-cost reductions are clearly demonstrated in service charges). Studies showing reduced vacancy rates and/or lower operating costs for occupiers include Miller, Spivey, & Florance (2008) and Pivo & Fisher (2009). Studies showing a rental premium include Reichardt, Fuerst, Rottke, & Zietz (2012), Fuerst & McAllister (2011a) and Fuerst et al. (2011). However, some studies find that eco-certification appears to confer no benefit in terms of higher capitalisation value of a property, rent or occupancy rate, for example Fuerst & McAllister (2011b).

These conflicting results are unsurprising for three reasons: (i) property valuation is inexact; (ii) data is not readily available for some of the variables; and (iii) sample sizes are small in some cases. However, the fundamental difficulty with attributing improved financial performance to eco-certification is the same difficulty that arises when trying to quantify the benefits of excellent customer service or customer satisfaction, namely, controlling for other variables, such as location, sector, age and condition of the property and the functionality of the building – its fit-out, size and specification. Certified buildings may command higher rents, but this "does not indicate causation as certified buildings tend to have superior building features" (Reichardt et al., 2012).

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<sup>12</sup> <http://corporate.marksandspencer.com/page.aspx?pointerid=8beddfecd4c24a04ac2d41728eb3dcd4>

<sup>13</sup> <https://www.gov.uk/getting-a-green-deal-information-for-householders-and-landlords>

Table 4.1 summarises research which has been carried out into aspects of the initial leasing process and factors which affect an occupier's decision to sign the lease.

Reference	Summary of Research	Methodology	Comments and Key Findings
(Benjamin, Jud, & Sirmans, 2000)	Summary of Research into Residential Brokerage	Annotated Review of 81 studies / Journal articles published prior to 2000, summarising key findings.	<ol style="list-style-type: none"> <li>1. Paper summarises research in the following areas:(1) brokerage firm characteristics; (2) broker commissions; (3) time on the market; (4) broker compensation; (5) the effects of brokerage on house prices; (6) regulation of the brokerage industry; (7) legal liability; and (8) international comparisons</li> <li>2. Paper concludes with predictions for the future of the residential real estate brokerage industry taking into account technology such as the internet</li> </ol>
(Seiler & Reisenwitz, 2010)	Summary of Research into Service Quality in Real Estate Brokerage	Review of Existing Research on Real Estate variants of SERVQUAL.	<ol style="list-style-type: none"> <li>1. Fewer than a dozen academic studies have been carried out researching service quality in residential real estate brokerage</li> <li>2. Whilst these have provided some insight, there is the need for larger samples, more sophisticated modelling and additional reliability and validity testing</li> </ol>
(Johnson, Dotson, & Dunlap, 1988)	Application of SERVQUAL model to measure service quality in real estate brokerage	Two questionnaires with similar sets of questions administered to 375 randomly selected homebuyers and 178 real estate licensees (both brokers and sales agents) in North Carolina during 1984-85. Factor analysis employed as data reduction technique to investigate the pattern of relationships in the correlated response data.	<ol style="list-style-type: none"> <li>1. Determinants of real estate service quality conform to those of Parasuraman, Zeithaml, &amp; Berry (1985) but differ in order of importance, and consist of: service assurances and responsiveness, tangible firm characteristics, tangible product characteristics, reliability of service, and service empathy</li> </ol>
(Okuruwa & Jud, 1995)	Satisfaction with Residential Brokerage: Measuring loyalty to broker. 347 observations from a nationwide survey: "The Homebuying and Selling Process"	Probit model comparing likelihood to use an agent again with length of search, difficulty with arranging financing, disclosure of fair housing law and marital status.	<ol style="list-style-type: none"> <li>1. Satisfaction is inversely proportional to length of search</li> <li>2. Satisfaction is lower for married homebuyers</li> <li>3. Satisfaction is lower for those with difficulty arranging financing</li> <li>4. It is higher when the broker discloses fair housing law requirements</li> <li>5. The last of these aspects is, perhaps, the only one under the control of the broker</li> </ol>
(Seiler, Webb, & Whipple, 2000)	Assessing extent to which service quality influences homebuyers to recommend the brokerage firm and to use the firm for future transactions	190 completed surveys from customers of a single real estate brokerage firm. Questions asked for perception only, and were a variant of SERVQUAL and RESERV. LISREL (Linear Structured Relationships) model used.	<ol style="list-style-type: none"> <li>1. Real Estate agent characteristics are important, so staff need to be knowledgeable, well-trained and personable</li> <li>2. Tangible aspects also matter, such as the visual impact of the office and its equipment and documentation</li> </ol>

(Seiler et al., 2010)	Investigation of the relationship between customer service, customer satisfaction and word-of-mouth recommendation to other potential home-buyers	Study compared findings from the full RESERV questionnaire with results obtained using a single-factor, 7-question variant. Data obtained from more than 1000 customers of a real estate broker was analysed using Structural Equation Modelling. Variants of the questionnaire included measuring perception only, perception and expectation in separate questions, and perception and expectation within the same question.	<ol style="list-style-type: none"> <li>1. A single dimension from the RESERV model, Professionalism, with seven items is a good predictor of a customer's likelihood to recommend a real estate broker</li> <li>2. Whilst the full RESERV model has slightly better explanatory power, the more parsimonious seven-item scale reduces the effort required of customers and so is likely to increase response rates</li> </ol>
(Kethley, Waller, & Festervand, 2002)	Application of Taguchi Loss Functions to residential real estate brokerage	Modelling of optimum and acceptable values of characteristics required by home-buyers. Properties with the smallest loss in the priority characteristics can be used to select which properties a real estate broker should suggest to potential buyers for viewing.	<ol style="list-style-type: none"> <li>1. Method provides a way to prioritise properties for efficient preliminary selection to improve customer service and satisfaction (<i>albeit probably superseded by ubiquity of on-line search engines!</i>)</li> <li>2. Technique can be applied to other real estate functions such as to select suppliers (Quigley &amp; McNamara, 1992; Wei-Ning &amp; Chinyao, 2005)</li> </ol>
(Leishman et al., 2011)	Investigation of the effect on office occupiers' choice of property of carbon-reduction features	Survey completed by 150 respondents able to influence business decisions regarding choice of premises.	<ol style="list-style-type: none"> <li>1. Rent, office size/layout and building/IT system access are the most important determinants of respondents' choice of office premises</li> <li>2. Functionality of space is becoming more important than location in determining building choice</li> <li>3. Carbon-reduction interventions deter occupiers if they interfere with functionality of space, necessitating reductions in rent</li> </ol>
(Falkenbach et al., 2010)	Discussion of sustainability in buildings from the perspective of Real Estate Investors	Review of prior research into sustainability in Real Estate, considering property-level drivers (the potential for increased rental income, reduced property costs and increased value), corporate drivers (image) and external drivers such as governmental and legislative requirements. Paper acknowledges that the studies relate to a small time period during which property prices were generally increasing, and that the price premium could have been transient; a reflection of the relative shortage of sustainable properties at that time.	<ol style="list-style-type: none"> <li>1. Several industry studies have found that occupiers say they would be willing to pay a rental premium for a 'more sustainable' building</li> <li>2. Research using CoSTAR or NCREIF data shows rental premium for LEED or ENERGY STAR certified buildings of order 5%</li> <li>3. Environmentally-certified buildings typically have lower operating / energy costs</li> <li>4. Certified buildings generally have lower vacancy rates and higher capital values</li> </ol>
(McAllister, 2012b)	Working Paper summarising results of 27 studies on the impact on property performance of eco-certification	An annotated bibliography which considers the scope of the data in the studies, sample size, modelling technique, error handling, omitted variables, the nature of the controls in the studies and whether results concur with intuition.	<ol style="list-style-type: none"> <li>1. Since paper reviews many of the same studies as Falkenbach et al, summary findings are similar, with most studies finding increased occupancy rates, rental premiums and reduced operating costs</li> <li>2. Most studies use hedonic OLS regression, but many ignore data errors and omit potentially relevant variables</li> <li>3. Eco-buildings may be of higher specification, "best in class", or in a better location</li> </ol>

Table 4.1: Summary of Research into the Leasing Process: factors influencing a customer's likelihood to sign a lease

## 4.2 The Service-Profit chain applied to Tenure and Lease Renewal

If a property owner is able to increase the loyalty of its customers, Monte Carlo simulations have shown that a small increase in lease renewal rates can lead to a large increase in profit.<sup>14</sup>

According to IPD data, in the UK only about one-third of office leases that expired in 2008 were renewed (Hedley, 2009) and this figure fell to just 20% in 2011 (IPD & Strutt & Parker, 2012). Around half of office tenants exercised their break clause in 2011. Lease renewal rates for UK commercial property were highest in retail, lowest in the office sector with industrial renewals being approximately midway between the other two sectors. These figures will vary with the economic cycle, and in a downturn a company which occupies several properties may choose to vacate one simply because its lease is the next to expire, regardless of satisfaction with the management of the property. In general, though, shorter lease lengths should enable the impact of superior customer service and customer satisfaction to be more noticeable on lease renewal rates.

Lease terms vary considerably even within a sector. Some leases allow scope for property managers to have a lot of contact with occupiers whereas FRI (full repairing and insuring) leases may involve very little interaction, particularly if the occupier pays no service charge. In the latter situation, scope for adding value to the property through “customer service” may be very limited, being restricted to aspects such as initial negotiations, straightforward legal processes, and clear documentation. Considering the retail sector, retailers in a prime shopping centre are likely to have close interaction with centre management, typically through a retail liaison manager and tenant association meetings. Conversely, in smaller centres, retail parks or High Streets there may be very little contact with the owner or manager. Opportunities for building relationships with occupiers are greater if the owner or managing agent provides services such as cleaning, security, landscaping and maintenance.

CRM theory emphasises the importance of building a good relationship with customers, in order to understand their needs and win their loyalty (Matzler, Hinterhuber, Bailom, & Sauerwein, 1996; Reichheld & Sasser Jr, 1990). The British Council of Shopping Centres has published a Customer Care Guide advising shopping centre managers how to look after their customers – emphasising the relationship with store managers, not just shoppers (Morgan, Purchase, Flatto, & Sanderson, 2012). They, like property managers in all types of property, should endeavour to gain the trust of occupiers (Freybote & Gibler, 2011) by communicating well, being responsive to occupiers’ needs, demonstrating integrity and providing good value for money when managing service charges.

Property managers need to be motivated and enthusiastic about giving excellent customer service and should have customer-focused processes to make life as easy as possible for occupiers. The London 2012 Olympics was famous for the 70,000 volunteer Games Makers who were trained to give good customer service by applying the “London 2012 Hosting Actions” summarised by the mnemonic I DO ACT – exhorting staff to be Inspirational, Distinctive, and Open, Alert, Consistent and part of the Team (LOCOG, 2011). These actions can be applied by property managers, who, “having been recruited for their attitude, must be given the tools and authority to do their job: appropriate training to ensure they have the knowledge and skills they need and suitable back-up if they encounter an issue they cannot deal with” (Sanderson, 2012a).

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<sup>14</sup> Unpublished commercial findings (Batterton, IPD.)

## **Correlations between Occupier Satisfaction and Lease Renewal Rates**

Correlations between aspects of customer service, overall satisfaction of occupiers and actual renewal rates (Kingsley Associates, 2004) found lease renewal rates to be 17.9% higher for those with 'good' or 'excellent' satisfaction compared with 'poor' or 'very poor'. Renewal rates were 12.3% higher for occupiers who rated highly their satisfaction with property management, and 28.5% higher for those that rated their overall satisfaction 'excellent' compared with those rating it 'very poor'.

Preliminary analysis of questionnaires completed by 2500 occupiers in 80 properties has been carried out to see how well responses to the net-promoter-type question "How likely are you to recommend your landlord?" correlate with responses rating occupiers' satisfaction with aspects of their tenure (Sanderson, 2012b). These indicate that satisfaction with communication, responsiveness, understanding needs, property management and willingness to recommend an owner or agent each show a correlation of around 0.65 with overall satisfaction as an occupier, whereas stated satisfaction with value for money for rent and service charges both show much lower correlations with overall satisfaction as an occupier (0.28 and 0.45 respectively). It is perhaps inevitable and predictable that respondents to satisfaction surveys will understate their satisfaction with costs, for fear of being charged more, but the findings emphasise the importance of effective communication with occupiers and responding promptly and effectively to their requests.

Table 4.2 summarises research which has been carried out into factors which affect an occupier's satisfaction and influence the decision to renew a lease

**Table 4.2: Summary of Research into Occupier Loyalty and Lease Renewal**

Reference	Summary of Research	Methodology	Comments and Key Findings
(Baharum et al., 2009)	Development and Empirical assessment of a Property Management Service Quality Instrument: PROPERTYQUAL.	Questionnaire used the five SERVQUAL dimensions: tangibles, responsiveness, empathy, reliability and assurance, plus six property-specific ones: cleanliness, building services, signage, security parking and building aesthetics. Respondents from 318 office buildings, although unclear how many actual respondents participated in study.	<ol style="list-style-type: none"> <li>1. “Property managers have better understanding of service quality than the tenants” – [this statement demonstrates a mis-understanding of service quality, which is “in the eye of the beholder”]</li> <li>2. “Reliability and responsiveness are ... more important to the tenants than to the managers”</li> <li>3. Assurance and reliability are ... more important to the managers than to the tenants”</li> <li>4. Occupiers found cleanliness, security and building services to be the most important property-specific aspects</li> </ol>
(Kingsley Associates, 2004)	Correlations between aspects of customer service, overall satisfaction of occupiers and actual lease renewal rates	Correlation analysis using US occupier satisfaction data and lease renewal rates between 2002 and 2004. No detail of sample size or potential bias although reference is made to studies of “tenants ... occupying more than a billion feet of commercial space.”	<ol style="list-style-type: none"> <li>1. Lease renewal rates found to be 17.9% higher for those with ‘good’ or ‘excellent’ satisfaction compared with ‘poor’ or ‘very poor’</li> <li>2. Renewal rates were 12.3 % higher for occupiers who rated highly their satisfaction with property management, and 28.5% higher for those that rated their overall satisfaction ‘excellent’ compared with those rating it ‘very poor’</li> </ol>
(Van Ree, 2009)	Investigation of quality dimensions which are important for property services supplier performance and occupier satisfaction	Adaptation of SERVPERF questionnaire with factor analysis to confirm dimensions and items. Nine service quality dimensions: <i>reliability, clout, reputation, awareness, competitiveness, collaboration, accessibility, competence and assurance</i> . Study participants included occupiers and suppliers of cleaning, catering and security services. For the customer survey 72 usable surveys, a 32% response rate, were received; only 30 surveys were returned from suppliers of the three types of service, cleaning, catering and security, combined.	<ol style="list-style-type: none"> <li>1. Customers had a better understanding of supplier organisations’ profitability than did the respondents from these organisations, based on dimensions such as <i>reputation, competitiveness and assurance, awareness, clout and collaboration</i></li> <li>2. Customer organisations have significantly lower perceptions of the service quality they receive than do supplier organisations that provide cleaning, catering and security services</li> <li>3. Of the nine service quality dimensions all apart from <i>clout</i> are strongly or moderately related to customer perceived service quality and customer satisfaction</li> <li>4. <i>Reliability, reputation and assurance</i> were found to have a moderate but significant relationship with profit margin, but, counter-intuitively, the regression coefficients were negative, [which could imply that the organisations are over-investing in these aspects, or, as seems more likely, the sample sizes may have been too small for statistically valid and reliable results]</li> </ol>
(Appel-Meulenbroek, 2008)	Assessment of aspects of property management which “keep, push or pull” office occupiers	Structured interviews with 38 office occupiers.	<ol style="list-style-type: none"> <li>1. Most aspects relate to satisfaction with the office itself and its location</li> <li>2. Customer Relationship Management is important to invoke loyalty to the property manager</li> <li>3. Retaining tenants requires more attention to relationships; it is insufficient to compete on price and building quality alone</li> </ol>
(Levy & Lee, 2009)	Study into switching behaviour and loyalty to property service suppliers	15 interviews exploring why a customer would switch from one supplier to another.	<ol style="list-style-type: none"> <li>1. Main reasons for switching: Core service failure, External Requirements, Relationships, Change in client’s requirements, Attraction by competitors and Pricing</li> </ol>
(Miller, Pogue, Gough, & Davis, 2009)	Research into the link between “Green Buildings” and Employee Productivity	Literature Review and study examining sick days and the subjective productivity percentage change after moving into a new building. 534 responses from tenants in 154 LEED or Energy Star certified offices.	<ol style="list-style-type: none"> <li>1. 2.88 fewer sick days reported on average after move into new building</li> <li>2. 12% ‘strongly agree’ that employees are more productive, 42.5% ‘agree’ that employees are more productive, and 45% suggest ‘no change’</li> </ol>

### 4.3 The Service-Profit chain: Reputation, Recommendation and Profitability

Marketing theory places great emphasis on the importance of reputation. Property owners and developers try to enhance their reputation with marketing techniques such as creating a recognisable brand to emphasise “corporate image and style”, in an attempt to achieve higher rents by “signalling the ‘success’ of a scheme and differentiating its characteristics from those of a competitor” (Appel-Meulenbroek, Havermans, Janssen, & Kempen, 2010; Ball, Lizieri, & MacGregor, 2001). In particular, many real estate companies emphasise their commitment to Corporate Social Responsibility (CSR) and Sustainability issues and publicise such commitment as part of their brand (and in order to attract media attention for their initiatives) (Cajias, Fuerst, McAllister, & Nanda, 2011; Falkenbach et al., 2010; Newell, 2008).

An investigation into the links between corporate social performance (CSP) and profitability found that REITs with a higher CSP rating on the Kinder, Lydenberg, and Domini (KLD) database do seem to improve financial performance as measured by Tobin’s Q<sup>15</sup> and Total Return (Cajias et al., 2011). These findings are supported by studies in other industries using ACSI and other American data (O’Sullivan & McCallig, 2012; Williams & Naumann, 2011) and reiterate the idea that reputation and profitability are linked, and that share prices of Real Estate companies do take reputation into account.

Several studies have been carried out to investigate the impact of branding, reputation and profitability in residential real estate (Anderson, Ouchley, Scott, Horton, & Eisenstadt, 2008; Benjamin, Chinloy, & Hardin, 2006; Frew & Jud, 1986; Hui, Lau, & Khan, 2011); these are discussed in Table 4.3, and generally show that branding has a positive effect on capital value, rental income and sales.

In Sweden, the existence of a well-established Customer Satisfaction Index specific to property, the Swedish Real Estate Barometer (SREB), combined with the Swedish Property Index of financial data compiled by IPD (Investment Property Databank) has enabled some analysis of overall customer satisfaction of office occupants and property performance (Westlund, Gustafsson, Lang, & Mattsson, 2005). Several strong correlations between customer satisfaction and measures of property performance were found, particularly towards the end of the period investigated. Total return showed a one-year lag behind customer-perceived quality, and most of the improved performance indicators were achieved via the reputation route (Word of Mouth recommendation) rather than through increased loyalty and retention. That lease renewal rates did not correlate particularly strongly with satisfaction was felt to be a function of the Swedish Office Market, which already had high renewal rates because occupiers rarely moved, even when they felt no particular loyalty to the owner or managing agent. In this respect, the Swedish Office market of 15 years ago, with standardised leases and outsourced property management functions, is perhaps not representative of the UK market today. This could be confirmed using a similar research method comparing UK occupier satisfaction data with IPD financial data. Existing occupier satisfaction data would need to be supplemented with new data as the UK does not yet have such a systematic and comprehensive index as the SREB.

As the Swedish study shows, a satisfied occupier is more likely to recommend the landlord or agent to other associates seeking to rent premises. In this way, good customer service could help to minimise voids, and a landlord with a good reputation may be able to charge a rental premium.

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<sup>15</sup> Tobin’s Q statistic is defined as the market value of a company divided by the replacement cost of its assets and is used by investors to assess the likely future performance of a company.

Conversely, occupiers who are dissatisfied with the service they receive may spread negative messages about the landlord, leading to more of the landlord's properties remaining un-let (an increased void rate). If a property has no tenants for a while, it generates no income and indeed may incur costs<sup>16</sup>. Profit should be inversely proportional to the void rate (assuming the rent paid by the new tenant is not higher than that paid by the previous tenant). Also it is common for a landlord to have to offer an incentive such as a rent-free period or other inducement to attract a new tenant, and this reduces net rental income. Even when a property is empty, if landlords outsource property management they would generally have to pay a retainer to the managing agent. Additionally, voids may start a downward spiral, particularly in a retail environment where empty units deter shoppers thus reducing footfall and profits for other retailers.

Little quantitative work has been done on the impact of a landlord's reputation, to assess, for example, whether adverse comments from detractors might deter a potential occupier from renting from a particular landlord; such research would be useful to many stakeholders.

Table 4.3 summarises research which has been carried out into branding, reputation and word-of-mouth recommendation for real estate organisations.

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<sup>16</sup> For example, full UK business rates are payable on commercial properties with a rateable value above £2,600 in 2011/2 (Gov.uk, 2012) once a property has been vacant for three months (six months for empty industrial property).

**Table 4.3: Summary of Research into Advocacy, Recommendation, Brand and Reputation**

Reference	Summary of Research	Methodology	Comments and Key Findings
(Benjamin et al., 2006)	The Effect of Branding in Real Estate Investigating rental income from similar branded and non-branded residential apartments complexes in Atlanta, 1996-2001	470 apartment complexes (1 – 3 bedroom), each containing at least 150 units. Probit modelling, with dependent variable being probability a complex is branded. Independent variables include hedonic apartment characteristics, ownership and management characteristics.	<ol style="list-style-type: none"> <li>1. Importance of local presence, and of ‘vertical alignment’ whereby owner carries out property and asset management</li> <li>2. Branding acts as signal of quality to prospective occupiers</li> <li>3. Economies of scale and value of local presence</li> <li>4. The branded apartments achieved gross rents at least 8% higher, with no reduction in occupancy rates</li> <li>5. Authors assert that “In markets for apartments, retail, hotels, restaurants and brokerage, a brand is visible to tenants and customers”, but that this does not apply to sectors “where the demand comes from firms and not consumers” namely office and industrial space</li> </ol>
(Hui et al., 2011)	Reputation: Property Management Quality and Profitability: Effect on apartment Sale Price of ISO9000 Certification and receipt of Property Management Awards in Hong Kong, 2007 - 2008	Seven private residential estates in one district of Hong Kong. Hedonic Pricing Model with explanatory variables such as age and size, and dummy variables for ISO9000 certification or being the recipient of a property management award.	<ol style="list-style-type: none"> <li>1. ISO9000 accreditation or receiving an award for property management increased sale price by 3 – 5% on average</li> </ol>
(Anderson et al., 2008))	Assessing whether franchising (and hence branding) affects performance of a residential real estate brokerage. Questionnaire sent to members of National Association of Realtors selling domestic properties in 1994. 186 usable responses received.	<p>OLS Regression:  <math>\ln S_i = b_0 + b_1 \text{FRANCHISE}_i + b_2 \text{AGE}_i + b_3 \text{FTSALES}_i + b_4 \text{MLS}_i + b_5 \text{OFFICE}_i + b_6 \text{CITY}_{ik} + e_i</math> with White’s Correction for heteroskedasticity in error terms</p> <p><math>\ln S</math> represents log of number of residential properties sold (a second equation for transaction volume is also estimated)  FRANCHISE is a dummy variable (1 or 0)  AGE is the age of the firm in years  FTSALES is the number of FTE sales staff  MLS represents multiple listing services affiliations to which a firm belongs  OFFICE represents the number of residential offices that the firm operates,  CITY represents the local population  <math>e_i</math> is the error term</p>	<ol style="list-style-type: none"> <li>1. Number of transactions increases with the length of time a brokerage firm has been in business (perhaps because of word of mouth recommendation)</li> <li>2. Franchising was found to increase sales volume by nearly 200%</li> <li>3. This did not translate into increased profit, however, perhaps because the sales were of cheaper houses, earning lower commission, and because the franchisee had to pay some of its revenue to the parent firm</li> <li>4. This contrasts with the findings of Jud, Rogers, &amp; Crellin (1994) that franchise affiliation confers a 9% increase in net revenues after affiliation fees are accounted for</li> </ol>
(Frew & Jud, 1986)	Comparing value of total home sales for 18 franchised and 66 independent residential real estate brokers in three cities in North Carolina	OLS Regression	<ol style="list-style-type: none"> <li>1. Franchise affiliation was found to increase the total volume of home sales for the average firm by nearly \$1 million per annum, on average</li> <li>2. Affiliation provides service quality assurance to homebuyers and sellers, especially when the participants are unfamiliar with the local market</li> </ol>

(Cajias et al., 2011)	Examining the impact on the profitability of American real estate companies of corporate social responsibility	Firms studied consist of REITs and other companies with substantial Real Estate holdings. Financial Data obtained from Datastream. Corporate Social Responsibility Performance obtained from Kinder, Lydenberg, and Domini (KLD) database.	1. REITs with a higher CSP rating appear to show improved financial performance as measured by Tobin's Q and Total Return
(Westlund et al., 2005)	Quantifying the relationship between customer satisfaction and Swedish Real Estate Company performance	Structural Equation Modelling with Partial Least Squares Estimation, using Swedish Real Estate Barometer (SREB) Satisfaction Index data and property performance from IPD, for Real Estate companies providing office accommodation during the period 1998 – 2002.	1. Correlations between customer satisfaction and measures of property performance 2. Improved performance indicators were achieved via the reputation route (Word of Mouth recommendation)
(Roulac, 2007)	Discussion of the contributions to the value of a property of "Brand, Beauty and Utility"	Subjective exercise given to Graduate Students, asking them to assess the relative importance of brand, appearance and functionality to 55 US and International single-family residential properties. Ostensibly empirical, but findings depend on opinions.	1. For the 55 properties, the analysis calculated the contributions of the three factors to be: Brand (46.35 %), Beauty (29.30 %), Utility (24.35 %), implying the functionality of a residential property contributes the lowest proportion to its price
(Appel-Meulenbroek et al., 2010)	Corporate Branding: the role of branding in CRE: Literature Review and Interviews with 19 real estate brokers, architects, lawyers and multinationals (but not owners or managing agents)	Findings from prior research invoked to create questionnaire, which was used as the basis for interviews with the 19 respondents.	1. Most important aspects were perceived by respondents to be: "accessibility of the location, typology of the location, quality of the finishings, the main entrance and the recognisability of the building." 2. Sustainability was not felt to be important, except by the multinationals

## 5. Researching the Service – Profit Chain in Real Estate

### 5.1 Property Market Cycles: Supply and Demand

*“The property cycle means the tendency for property demand, supply, prices and returns to fluctuate around their long term trends or averages”, (Baum, 2000)*

To be able to attribute superior property performance to aspects of customer service, it is crucial to understand the nature of property market cycles. If a property has capital growth, increased rental income and few voids, is it because of the management of the property or because of supply and demand? If there is a surfeit of properties and few customers, landlords and agents will have to work harder to attract and retain occupiers. Commercial property markets typically undergo cycles comprising demand outstripping supply (a shortage of property), rental increases (as owners are able to charge more), development of new property (as developers and investors deem it worthwhile financially to buy and develop land), reduced demand (as asking rents exceed the amount occupiers would be willing to pay) and excess supply (as newly-developed property comes onto the market) (Ball et al., 2001; Barras, 1994; RICS, 1994). Development of a large commercial building can take many years, and by the time it is ready for occupation the market situation – rental income, capital growth, demand etc - which made development seem viable several years earlier may mean that the property is no longer an attractive investment.

Some types of real estate may ride a market downturn better than others; for example, in a market downturn, investors might try to minimise risk by avoiding older properties with short leases whose occupiers’ businesses may be more vulnerable to recession. In this scenario prime property might retain its value better than secondary property regardless of property management quality and intervention (McAllister, 2012a).

Apart from the general economic cycle, demand for a particular sector may vary for reasons outside the control of a property manager. The desirability of a location may change as a result of infrastructure changes such as new transport links or other initiatives to improve the public realm. The arrival of new businesses nearby can have a positive or negative impact upon an existing business, depending upon whether the newcomer is a direct rival which will compete for a share of the business or an amenity or other attraction which will increase footfall or custom for all.

Property sectors have to respond to changes in technology and business’ priorities, so that serviced offices are competing with traditional offices and overall demand for office space may decline as internet connectivity enables more staff to work from home or share office space by “hot-desking”. Likewise, retailers may require fewer shops as demand for on-line retailing increases (Jordan, 2012), but may need more warehousing to be able to store and distribute goods. The nature of the industrial units required is also changing, for example, more data-centres may be needed for storing business data (“the cloud” actually needs to be sited on terra firma).

These are factors which the property owner or manager can do little to control, but applying the principles of relationship marketing and customer relationship management should improve rapport with occupiers and increase the proportion of leases which get renewed and the number of positive word-of-mouth recommendations.

## 5.2 Determinants of Property Performance

Many researchers have applied econometric models to try to establish the factors affect rental levels and capital growth for retail, office and industrial commercial property. A widespread approach is to use hedonic regression modelling with rent or capital value as the dependent variable and aspects of supply and demand as the independent (explanatory) variables. A review of studies prior to 2000 has been carried out by Higgins (2000). Typical variables include:

- Physical building characteristics, such as the size, age and location of the property;
- Supply variables, such as vacancy rates, total stock availability and new construction orders;
- Demand variables such as employment in the relevant sector, GDP and other productivity measures.

Aspects specific to an asset class are also included; for example, when modelling retail rents, relevant demand factors include population, consumer expenditure and confidence, disposable income, type of anchor store in a shopping centre, traffic (vehicular and pedestrian) and retail sales (see, for example, Sirmans & Guidrey, 1993; Tay, Lau, & Leung, 1999; Tsolacos, 1995). When seeking to explain industrial rents, explanatory variables include industrial employment, manufacturing output, industrial floor-space and building-specific features such as the number of dock high doors (Buttimer Jr, Rutherford, & Witten, 1997; Feribach, Rutherford, & Eakin, 1993; Higgins, 2000). Office rents have been found to depend upon factors including office employment, required floor-space per employee, office vacancy rates, physical building characteristics and location (Hendershott, 1995; Hendershott, Lizieri, & Matysiak, 1999; Sivitanides, 1998). Other explanatory variables included in some models are interest rates, bonds and equity indices, since these affect investment in real estate; leaving aside discussions of a balanced portfolio, an investor is likely to invest in property only if the predicted returns exceed those from other forms of investment.

Many models look not at absolute rents but at changes in rent from one period to the next, for example McGough & Tsolacos,(1995). These autoregressive ARMA<sup>17</sup> models aim to predict future rents based on previous values. Another form of modelling used is structural equation modelling with simultaneous equations of interrelated endogenous and exogenous variables<sup>18</sup>, for example equations for demand, vacancy, rent and construction (Brooks & Tsolacos, 2010). The dependent variable in one equation may be used in another equation as an endogenous explanatory variable. Simultaneity arises by making assumptions such as market clearing, whereby the demand for new space equals the supply.

Whichever econometric method is used, empirical analysis depends upon having data for the variables, and the accuracy of the results depends upon both the accuracy of the model (which can be tested statistically by methods such as Ramsey's RESET test<sup>19</sup>) and upon the accuracy and sufficiency of the data used. The most comprehensive source of financial performance data for individual properties is probably that compiled by Investment Property Databank (IPD), which comprises data on more than 62,000 properties in 25 countries (IPD, 2013). However the IPD Index is appraisal-based, and whilst it has been found to show reasonable agreement with transaction-based data (Devaney & Diaz, 2011), there is a tendency for appraisers to rely on previous values, which leads to smoothing of the indices (Geltner, 1991) and may lead to inaccuracies when performing

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<sup>17</sup> ARMA – autoregressive moving averages

<sup>18</sup> The value of an exogenous variable is determined outside the equation whereas the value of an endogenous variable depends upon the values of other variables within the equations.

<sup>19</sup> To check for mis-specification of the functional form of an equation, an auxiliary equation is evaluated, using higher powers of variables to exaggerate any errors which may exist in the model and the results compared with the original model

regression analysis with property value as the dependent variable. Regression analysis involves using data to quantify the contribution each explanatory variable makes to the dependent variable, and using statistical methods to check whether the values are significant or whether they could occur by chance. Various tests are required to test if the Gauss-Markov Assumptions apply or whether corrections have to be made for aspects such as heteroskedasticity<sup>20</sup>, non-stationarity<sup>21</sup>, multicollinearity<sup>22</sup>, non-normality of data etc, which affect the standard errors of the coefficients and hence whether the tests of significance are sufficiently robust.

The validity of models should also be tested by applying them to out-of-sample data, to see if the formulae give accurate predictions for data which was not used in the initial analysis. Typically the formulae include autoregressive variables, meaning that the value of a variable at a particular time  $t$  depends on its value or that of other variables (Granger-causality) at an earlier time, say  $t-1$  or  $t-2$ . Risk Analysis can be carried out using Monte Carlo simulations to assess the impact of changes in the values of the variables in the equations which are used to predict future performance (Hoesli, Jani, & Bender, 2006).

When applying multivariate regression analysis or other techniques such as ARMA modelling there are many potential pitfalls, such as missing out explanatory variables from the equations. Assessing the impact of aspects of customer service is complicated because there are multiple explanatory variables, whereas for the studies on the impact of eco-certification, for example, there is just the one explanatory variable being evaluated – certification status, with hedonic characteristics being included to control for other factors. It is important to build upon previous research to establish which determinants of customer service quality should be used as explanatory variables in the modelling, so that the calculations do not simply consist of “data mining” (Brooks & Tsolacos, 2010), trying every possible combination of the independent variables to try to come up with an empirical formula to predict the dependent variable: effect on property performance. If there are too many explanatory variables in a regression equation, some will appear to be significant purely by chance. If  $x\%$  size of test is used, on average one in every  $(100/x)$  will have a significant slope coefficient by chance alone<sup>23</sup> (Brooks & Tsolacos, 2010 p.123).

Since property valuations are inexact and capital growth and rents depend upon the property market cycle, the calculations may be able to do little more than give an indication of the aspects of customer service which property owners and managing agents should expend most effort for improved financial performance.

Another caveat is that it is questionable whether any landlord has sufficient market presence for customer service to be a significant differentiator when a customer wants to be in a particular location. The functionality of the property and its location are likely to be overriding considerations for a prospective or current occupier, so research is needed to investigate to what extent customer service is able to exert an influence on retention rates and property performance.

Section 5.3 tabulates areas for proposed research, with the aim of filling gaps in current knowledge and determining whether treating the tenant as a valued customer can result in fewer voids, increased likelihood of lease renewal, rental uplift and enhanced capital value.

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<sup>20</sup> Heteroskedasticity occurs when the residuals (errors) in the Ordinary Least Squares regression equation do not have constant variance

<sup>21</sup> With non-stationary data, means, variances and/or autocovariances vary over time (Brooks, 2008), and can lead to spurious regressions, showing apparent correlation between two variables simply because both are changing with time.

<sup>22</sup> Multicollinearity occurs if explanatory variables are correlated with one another

<sup>23</sup> The size of test is defined as the probability of rejecting a correct null hypothesis; the distribution of a test statistic is such that it will take on extreme values on occasions purely by chance

Research Question	Proposed Research Method	Comments
1. What is the Relationship between Customer Service and Occupier Satisfaction?	<ul style="list-style-type: none"> <li>Analyse occupier satisfaction feedback, looking at customer expectations, perceptions, importance and performance for determinants of occupier satisfaction</li> <li>Review “lost enquirers’ feedback” and post occupation studies as well as exit studies to gain greater insight</li> </ul>	Principal Components Analysis and Factor Analysis will be required to check for multicollinearity amongst the determinants of satisfaction.
2. What is the Relationship between Occupier Satisfaction and Property Performance?	<ul style="list-style-type: none"> <li>Null hypothesis Ho: All else being equal, the mean performance of individual properties with highly satisfied customers is no different from that of properties with poor customer satisfaction.</li> <li>Alternative hypothesis H1: The mean performance of individual properties with highly satisfied customers is better than that of properties with poor customer satisfaction.</li> <li>Similarly at an aggregate level, the performance of real estate companies achieving differing levels of occupier satisfaction can be compared</li> <li>The vacancy rates for individual properties and for companies can be analysed in a similar way</li> </ul>	<p>Occupier satisfaction data to be obtained by questionnaire using a large sample.</p> <p>Financial data to be obtained from Investment Property Databank.</p> <p>Test whether mean returns from property with high occupier satisfaction are significantly greater than those from properties with low occupier satisfaction, or whether companies with high levels of occupier satisfaction have lower vacancy rates.</p>
3. Which metric (occupier satisfaction, Customer Effort Score or Net Promoter Score) is the best predictor of lease renewal?	<ul style="list-style-type: none"> <li>Correlate occupier responses to questions on overall satisfaction, ease of conducting business with owner or managing agent and likelihood to recommend with measures of property performance such as likelihood to renew, actual renewal rates, void rates and yields of properties</li> </ul>	

4.	What aspects of Customer Service have the most impact on property performance?	<ul style="list-style-type: none"> <li>• Apply a hedonic multivariate regression model to evaluate the relative importance of determinants of customer satisfaction and their impact on property performance</li> </ul>	It will be necessary to check whether Gauss-Markov Assumptions apply by testing for heteroskedasticity and normality of data and adjust confidence intervals if required. Perform other statistical tests for stationarity and functional form etc.
5.	Is it possible to quantify the return on investment in customer service for commercial real estate?	<ul style="list-style-type: none"> <li>• Econometric modelling should enable some indicative quantification of the increased return on property for differing levels of customer satisfaction.</li> <li>• Conduct case study to assess the additional costs associated with investment in customer service, to see if the net return is positive</li> </ul>	To have a positive return on investment, the financial benefits accruing from loyalty, reputation and ability to charge a rental premium must outweigh the costs. There is no point in over-investing in customer service.
6.	How does the reputation of a Real Estate company affect performance?	<ul style="list-style-type: none"> <li>• Obtain opinions on brand awareness and reputation of real estate companies from stakeholders such as retail directors, occupiers and general public, using focus groups, interviews or surveys, and compare results with the financial performance of companies at different points of the “reputation spectrum”</li> <li>• Investigate the proportion of new leases taken by occupiers with previous experience of the landlord or agent</li> <li>• Evaluate new occupiers’ reasons for signing their lease</li> </ul>	
7.	Is there a difference between retail, office and industrial? Is customer service / occupier satisfaction more important for one sector rather than another?	<ul style="list-style-type: none"> <li>• Carry out regressions and correlation analysis for the three main commercial asset classes separately</li> </ul>	

## 6 Summary and Conclusions

This paper shows that customer-centric business processes can benefit organisations by increasing loyalty and reputation and that this may translate into increased profit. Research into the service – profit chain in real estate has confirmed a number of positive links, including the importance of good customer service by leasing agents in the initial leasing process and the beneficial effect on share price and total returns on property of a good reputation. Studies have proved that satisfied occupiers are more likely to renew their leases, but there has been little academic research into the main determinants of service quality and customer satisfaction in Real Estate. In particular, more work is needed to determine which aspects are in the lower right quadrant of the Importance - Performance Grid, aspects which are of high Importance but where the service supplier's performance is weak.

Econometric modelling techniques have been applied extensively to real estate over the past decade, and multiple regression analysis should enable a quantitative assessment of the aspects of customer service (the independent or explanatory variables) which have most impact on property performance (the dependent variable). However, as this review has shown, there are caveats, including the multitude of factors which affect property performance but which are unrelated to customer satisfaction with the service they receive, such as the economic climate and the requirement to occupy a particular building or location.

Untangling the variables is complex, which may explain why so little quantitative research has been carried out on the service-profit chain applied to real estate. However improvements in the theory of econometric modelling and the increasing power of computers to perform complex statistical and mathematical techniques mean that the time is ripe to take advantage of “opportunities for researchers interested in property management to provide description, analysis and evaluation of contemporary approaches to delivering and procuring property asset management” according to McAllister (2012) in his aptly-titled recent Working Paper “Why do Research on Commercial Property Management? Somebody HAS TO!

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