Sitting on a Goldmine:
Making The Most of City-Owned Real Estate

By Alan R. Gianini and Ann Ludwig

A new course offering from IRWA...

Course 303, Real Property Asset Management

IRWA and the International Education Committee are interested in providing members and course participants with the best and the most current eduction and training possible. New directions in real property asset management are being heard throughout both the public and private sectors of the industry, and IRWA is taking a leadership role in training those who will be managing these programs in the future.

IRWA's goal is to provide the highest quality training possible, and for its asset management course set about finding a course developer capable of meeting that task. As a member of IRWA, an IRWA certified instructor and Chief of the Office of Asset Management, State of California, Department of Transportation, James D. Gardner fit that description and agreed to assume that role.

The pilot presentation of IRWA Course 303, *Real Property Asset Management*, was successfully conducted in Seattle, Washington on April 1, 1993. This is a one-day course on how to establish a successful asset management program in an organization. It focuses on the strategies and prerequisites for developing a program, and provides a plan for successful implementation. The course was developed for real estate professionals and managers of organizations with extensive real estate holdings.

People who have completed IRWA courses 700 and 701 or who are involved in managing real estate for an organization, a public or quasi-public agency would benefit most from this course.

Real estate asset management is an emerging field. As demands for services continues to grow and sources of income decreases, public agencies are turning to their real estate for solutions. The following article, "Sitting on a Goldmine: Making the Most of City-Owned Real Estate," by Al Gianini and Ann Ludwig, is reprinted with permission from the May 1990 issue of *Western City*, the monthly publication of the League of California Cities. This article provides some examples of how real estate assets can provide some answers.

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How did Pasadena fund its $140 million pension fund deficit? How did Redondo Beach, Oceanside, San Mateo and South San Francisco increase their supplies of low- and moderate-income and senior housing by over 400 units? How did Ione; Mountain View; Fairfax County, Virginia; Phoenix, Arizona; and San Diego build and renovate city halls, police and fire stations, conference centers, administrative buildings and recreational facilities in this period of declining resources for capital improvements? They did it by managing their real estate assets.

For years now, there has been a growing crisis in local government. Traditional sources of revenue are either unpredictable or are disappearing altogether. At the same time, the scope and level of demand for services continues to grow. Localities caught in this squeeze cannot rely on taxes and subventions to get the job done; new methods of generating revenue must be found. Cities such as Pasadena, Redondo Beach and Mountain View, to name a few, have turned to leveraging and managing their real estate holdings to develop perhaps one of the last opportunities left to local governments to generate new, locally-controlled revenue streams.

Los Angeles County was the first jurisdiction in California to establish an asset management program under the leadership of Jim Hankla, then CAO of Los Angeles County and now City Manager of Long Beach. By leasing county property to private developers, Los Angeles County was able to create a stable source of long-term revenue without increasing taxes.

"The new revenue generated by efficient management of real property assets is only one of the benefits of an asset management program," says Hankla. "Unused and underused sites are returned to property tax rolls. Commercial development produces new sales and income tax revenue. Construction-related and permanent jobs are created. Finally, the county realizes earnings from its surplus property while retaining ownership and control."

What ia asset management? An asset management program is a system for organizing information on owned and leased real estate to justify real estate decisions on a financial basis and to develop a strategic plan for real estate utilization which takes into account the city's operational and financial objectives. Asset management is more than "doing a deal" on a piece of surplus city property.

"I was floored when I first came to work for the city and found there were buildings people moved out of and forgot about," Marilee Utter, Director of Denver, Colorado's asset management program, recalled. "The assessor's office provided an annual list of city-owned properties, but it offered little indication of what buildings were on each site or what the current uses or value were and it provided no financial analysis of the affects of maintaining, developing or selling the property."

Local Governments can take some solace in the fact that many corporations have just recently undertaken sophisticated strategies to manage their real estate. These corporations are just now waking up to the realization that their real estate assets, which at book value typically comprise 25 to 40 percent of the corporate balance sheet, are as important to manage a cash, marketable securities or any other asset.

A recent article in Business Week dealt with the subject of corporations managing their real estate assets.

> ...Being in charge of real estate holdings used to be the last stop before retirement. But at more and more companies, it is now the province of fast-track managers who figure prominently in high-level strategy sessions. Some of the more property-conscious companies, including Boise Cascade Corp. and Campbell Soup Co, no longer cram real estate records into filing cabinets. Instead, they treat them just as if they were a stock portfolio, feeding them into computer data banks, which are revised daily. "At a moment of crisis, you don't want to do a major study that will take weeks just to find out what you have," says Kevin Haggarty, Executive Vice President at Cushman & Wakefield, Inc., a New York real estate brokerage." (*Business Week*, September 11, 1989, pp. 96-97.)

Who is doing asset management? A diverse group of communities and local agencies are engaged in managing and developing public real estate. In the Spring of 1988, the California Department of Commerce (DOC) conducted a survey of cities throughout California in an attempt to discover the extent and experience in asset management amount California cities. DOC also sought to discover the type of development these communities were pursuing.

The study revealed that 43 percent of the respondents were not actively involved in and had no experience in public asset management. Forty percent had some asset management experience, and 17 percent were very involved in asset management and public real estate development.

The types of projects reported by cities with experience in public real estate include commercial (50 percent), community facilities (28 percent), industrial (13 percent), and housing (9 percent). Cities are improving the use of existing facilities, re-using assets for other city agencies, releasing city-owned assets to the highest bidder, re-using city-owned assets through a Request for Proposals (RFP) process and using property to fulfill economic development objectives.

An interesting fact is that both large and small cities have active programs. Although the sample was so small as to be ungeneralizable, the tentative conclusion of a recent Urban Land Institute study, conducted by the University of Southern California, was that the urgency of finding new revenue sources has made communities of every size cognizant of the opportunities to be found in real estate asset management.

Denver's asset management program demonstrates that cities can realize substantial cost savings even in depressed markets by taking advantage of the city's status as a major tenant. When the program first started, the city had thirteen different office sites which it now plans to cut

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to four. Utter's staff found 35 separate vehicle maintenance facilities operated by different agencies. They are cutting these facilities down to five–a central facility and four satellites. Through these consolidations and closer inspection of the city's leases, Utter's staff has cut average lease rates to $7.75 a square foot from $9 for an annual savings of $350,000.

On a much smaller scale, Ione, California (pop. 2,500) recently purchased 500 acres of state surplus property from the California Department of General Services. The city selected a developer through an RFP process. Then, through a double escrow process, the developer provided the city with the funds to purchase the land in return for 340 acres. The developer plans to build a shopping center, restaurant and motel complex, 800 custom homes and up to 480 units of multi-family housing. On the remaining 160 acres, the city will build a golf course, with bond financing to be paid by the developer, a sewer treatment plant, a city hall, and police and fire stations.

Why should a local government organize for asset management? Although the Urban Land Institute study indicated that California cities are aware of the opportunities to be found in asset management and concluded that some cities are quite sophisticated in their asset management practices, many are still daunted by the idea of organizing for asset management. City managers and local officials worry about the cost of setting up an asset management program and wonder why they can't just pick a site and make money off the dirt.

Cities have certainly tried this approach. Oftentimes, cities that do not educate local officials about the purpose and philosophy of asset management find themselves embroiled in political battles before they can even issue an RFP. Pasadena is a model of what can be accomplished when a city implements an asset management program, which maximizes the value of municipal assets and dedicates future revenue streams to specific needs. City officials emphasize repeatedly that they were successful in funding a $140 million pension fund liability and $60 million in infrastructure needs only because policy makers bought into the philosophy of using long-term assets as a revenue source.

Another problem with forging ahead without doing the site homework is that the project is liable to fall apart half-way through the process. There may be site problems, such as toxic problems, which were not caught because no preliminary research was done. The city may lose the developer they selected because of frustration over delays due to lack of expertise of agency staff, staff turnover, and/or an inability to get a decision out of the city on a key development issue. Problems may also occur in the negotiations process, most likely in the financing areas, because he city doesn't understand the economics of developing on its site.

Finally, cities that proceed without organizing for asset management may never see the cash return they expected from a deal. Even if a deal is successfully completed and all the papers are signed on the dotted line, cities that have no mechanism for monitoring their leases and other agreements cannot expect to realize the true financial return. For example, Ventura County hired a certified public accountant two years ago to audit their existing leases. The audits along uncovered approximately $800,000 in unreported or misclassified income that the county had not collected. The future financial impact of these disclosures is several times that amount.

To determine if your city is managing its real estate assets, ask your staff the following questions:

1. Does you city have a computerized inventory of all city-owned and leased properties?
2. Does the description of the properties include physical data on the site, zoning, easements and use of property?
3. When was the last time city-owned properties were appraised?
4. Ask for an analysis on a lease v. own decision that was done in the last year.
5. Do you have a listing of surplus properties?

At a minimum, the city should have some listing of its real estate holdings and the approximate values of those holdings. Ideally, the city should adopt a formal plan on real estate management and establish clear goals for the real property managers.

How does a local government organize for asset management? Perhaps we can gain some insight on organizing for public asset management by understanding common elements in a successful corporate real estate program. A survey conducted by the Industrial Development Research Council (IDRC), an organization of corporate real estate mangers, identified several factors which have the largest effect on the ability of the corporate real estate department to affect the company's bottom-line.

1. The company has adopted a formal plan for facilities planning and real asset management.

2. The company's computerized property inventory includes current approximate market value of each property.

3. The real estate department is consulted regularly concerning the role of real estate in corporate business plans.

Organizing for asset management requires four basic steps:

1. Developing an asset management philosophy/value in the city. This philosophy or value will guide the city's decision-making process. It is important the key officials understand the value of asset management so they can make consistent and informed decisions and educate others. "Any real estate asset management system that does not begin here will inevitably return here, because decision making will slow if the local government's commitment to and understanding of the process is inadequate." (Source: ICMA, MIS Report, Volume 21/Number 4, April 1989 "Establishing a Real Estate Asset Management System," p. 3).

Denver's asset management program provides a good model on how cities should proceed. Initially, a policy framework was devised. This took the form of a goal statement and 16 guidelines.

Through the drafting process with city staff and private sector representatives, the statements evolved from specific, measurable standards to much broader, less constraining policy statements. For example, "The city's real estate portfolio should appreciate in value by at least x percent per year," became "The financial value of the city's real estate portfolio should be preserved and increased over time." The overall goals–"To maximize the long-term benefit of the city's real estate assets"–deliberately stresses a long-term horizon versus the short-term cycles of real estate markets and the immediate needs of the city. Similarly, it acknowledges that "public benefit" can be measured in both financial and non-financial returns (housing, jobs, cultural enhancement). Currently, the asset management policy is being established by executive order and will become the foundation for all future real estate decisions.

2. Developing an asset management team. Deciding who will be in charge and what expertise is available internally is the second step to

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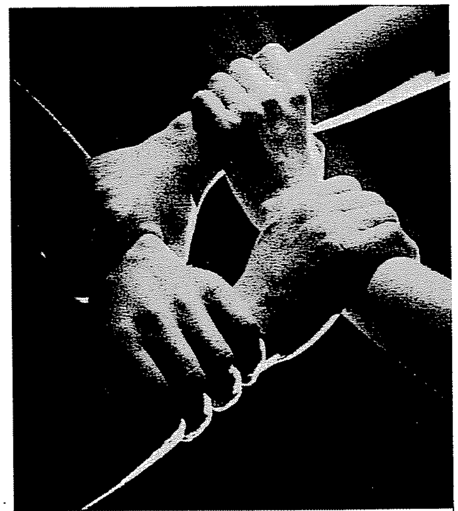

tion. When there is the slightest doubt, ask.

In summary, there is little reason for cultural resources to delay or impede projects provided adequate planning and decision-making is accomplished, and agreed to, before implementation. During implementation, the decisions already made must be adhered to as much as practical. The manner in which cultural resources were considered during this project is a case of a team, "risk management" and "project management."

Records Management, Disposal and Retention

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future decisions and can be of unique value to historians and students. These records need to be identified for permanent preservation. When records need to be maintained for longer periods of time or permanently preserved, microforms should be considered.

Microforms can save space and ensure the integrity of the records. When microforms are created in accordance with the required standards, the master negative is stored in a security vault. In case of disaster, a complete duplicate from the microform file can be created. Though microforms have many obvious advantages, their use should be carefully considered. The conversion of hard copy records to microform is costly. The costs and benefits of maintaining the records in hard copy should be weighed against the costs and benefits of converting to a microform before a decision is made to convert to microforms.

Now is the time for businesses that do not have a records management program in existence, to create and develop a program that meets their needs so they will be prepared for the accumulation of records.

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organizing for asset management. The asset management team will do many of the first steps in the asset management team. After all, the city knows the staff's backgrounds and has the best access to important documentation, such as tax assessor's records and deeds and titles to the property.

3. Developing a property information system. The asset management team should first do a preliminary evaluation of its real estate holdings and develop that into a property information system. Denver's city code has, for years, required the city to maintain an inventory of city-owned real estate. A simple list from the assessor's office has in the past served this purpose. However, a computer run of addresses, lots and blocks and schedule numbers tells little about improvements, current use, future opportunities or even market value.

Therefore, the asset management team should inspect any parcels whose location or use is not immediately apparent. Denver's asset management office began a physical site inspection on each of its 2,500 properties to develop a market-oriented, useful inventory. Two graduate school interns were hired to work on the project that is approximately 40 percent complete.

Uses for the inventory are numerous. The most immediate benefit is that the city is now able to respond rapidly to public inquiries regarding public real estate. From the portfolio manager's perspective, however, there are two primary uses–to identify opportunities and to determine excesses and needs. By sorting for key underdeveloped or highly marketable properties, the portfolio of 2,500 can be pared down to perhaps 200 properties requiring further evaluation. Mismatches of use and value then become the basis for a specific property strategy.

The inventory can also be used to determine excesses and needs. For example, Denver wants to encourage downtown housing, but has little suitable surplus property available. Hence the city may need to acquire property. Conversely, there is an over abundance of city-owned industrial land in city fringe areas whose disposition could finance other projects.

4. Preparing Analyses and Planning. Once the priority sites have been identified, those having private development potential should be more carefully evaluated for their economic and physical development potential. The city should do a market analysis to determine the feasible uses for the site. This study should include land-use and environmental factors, as well as economic factors that affect the value of the site. A financial feasibility study (appraisal) should also be done to determine the highest and best use of the site, and the city should do a community impact analysis. At this stage, a phase one toxic analysis is also appropriate. A phase on a analysis involves checking past uses of the property through a deed search for any indication of potential toxic problems.

Denver's Office of Asset Management provides the city with a centralized source for rigorous financial analysis and feasibility review on issues such as lease versus purchase decisions: sway versus sale decisions; renovation versus abandonment decisions; public-private project structure; reuse options; and financial alternatives.

Examples of projects handled by the office to date include: reuse plans for a surplus wastewater treatment plant, an airport, convention center, community theater and historic fire station; acquisition and remodeling of a new city administrative center acquisition and resale of an historic temple to avoid demolition; and development of a ten-year facility master plan for administrative space.

The office's planning function encompasses the evaluation of immediate-, medium- and long-range

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value of properties and anticipation of the needs of the city in those time frames. Thus, property currently being purchased at an apparent premium for surface parking is also being assembled as a sports stadium site in the medium term and as a critical inner-city green space in the long term. Prior to the establishment of the asset management office, such opportunities had not been systematically evaluated.

Denver is also establishing an ongoing management program to undertake tasks like the examination of lease arrangements, (e.g. $1 per year for 99 years is rarely appropriate), mediation of agency priorities for vacant facility use, review of operation and maintenance costs, and clearance of high carrying-cost parcels. It appears that asset management and public land development through joint partnerships with private developers are ideas which are spreading across the nation as communities seek new sources of public revenues and attempt to promote economic development.

The notion persists, however, that asset management is simply a product–like an inventory system or a policy statement–that can be acquired and then maintained as needed. Instead, asset management needs to be viewed as an ongoing process dependent on in-house expertise and affected by local and regional real estate markets.

Therefore, it is essential that public agencies formulate strong, comprehensive public real estate programs in order to reap the substantial benefits available through joint development projects. This remains a challenging vision for most local government.