

Long-term leasing of public buildings: developing a program

by Robert J. Niccum



What do you do with a closed school? Politically difficult as closure was, even more distasteful was the prospect of selling the schools.

Robert J. Niccum is Chief Realty Agent for the Los Angeles Unified School District and a member of Los Angeles Chapter 1. He holds a Master of Business Administration degree from California State University, Fullerton. Since developing the leasing program described in this article, he has advised a number of public agencies regarding disposition of their property.

Infrequently do public agencies find themselves in the position of leasing out their buildings. More frequently, when an agency no longer has need for a facility, the property is sold.

However, occasions arise where an agency wishes to retain ownership of a building for which it has no immediate use. The rarity of the situation may mean that the organization does not have a well-defined procedure for finding a tenant and leasing the facility.

The purpose of this paper is to describe the approach used by one agency in developing a program for leasing several of its facilities. While some of the issues that arose may not apply to other organizations, the process as a whole should be instructive to any public entity preparing to lease its property.

Background

The Los Angeles Unified School District, with 826 schools and 674,270 stu-

dents, is the largest school district in California and the second largest in the United States. Among the areas within the 708 square mile expanse of the district is the western San Fernando Valley, where school enrollment has declined dramatically since the early 1970s.

Beginning in 1982, the Board of Education voted to close a number of low-enrollment schools. This action was not taken lightly, since many parents, teachers, and administrators opposed the closure. Nevertheless, financial hardship and pressure from state "watchdogs" persuaded the board to shutter schools whose population had dwindled.

What do you do with a closed school? Politically difficult as closure was, even more distasteful to many was the prospect of selling the schools. Therefore, the board decided that schools which were not needed for other purposes — such as administrative centers — should be offered for lease. While the real estate staff of the school district had extensive experience in writing leases, we had never before leased out an entire school. The prospect called for long and careful forethought.

Because California schools are governed by architectural standards that are among the strictest to be found any-

where, and because the district might reopen these schools when the leases expired, we realized that lessees would have to use the buildings virtually unchanged. This fact, combined with city zoning ordinances, eliminated a number of alternative uses for the schools, such as office complexes and light industrial facilities.

Ironically, it soon became apparent that the only likely lessees were private schools: the district's competition! Private schools had contributed significantly to the enrollment losses which had closed our public schools. But legal counsel advised that operators of private schools could not be prevented from participating if the district's schools were offered for lease.

Ground rules

The California Education Code governs the procedures by which school districts dispose of their property. In general, districts intending to lease their real property must establish a minimum bid for the property, fix a date when bids will be received, and publish notice of the property's availability. The law requires that sealed bids be received, but also provides that oral bids must be solicited. So, in effect, the process becomes an auction.



Oso Avenue School in Woodland Hills, Ca.

The Los Angeles Unified School District writes about 140 such leases each year, involving use of auditoriums, classrooms, and athletic facilities at operating schools. However, although the opportunity is always provided in accordance with the law, there is virtually never competitive bidding for these leases. With hundreds of auditoriums and thousands of classrooms in the district, there are plenty of available facilities and little need to compete for their use.

Not only state law but local zoning ordinances had to be taken into account. In most residential areas of the City of Los Angeles, schools are a conditional use. Approval must be obtained from the planning commission before siting a school at a particular location. Since public and private schools constitute different conditional uses, any lessee intending to operate a private school at the former site of a public school would have to apply to the city planning department for a new approval.

With state law, local zoning, and Board of Education policy as starting points, we set out to develop a program for leasing the closed schools. The planning focused on three sets of activities: (1) establishing the parameters of the leases; (2) writing the lease documents; and (3) letting potential lessees know that the schools were available.

Establishing the parameters

There were many decisions to make

before any action could begin. Some details of the leases were dictated by law, policy, or common sense. Others required careful analysis, and a few came down to arbitrary choices.

Most discussion of the optimum duration of the leases revolved around terms of five to ten years. The final compromise was a five year lease with a five year option. During the second five years (if the option was exercised), the school district could cancel the lease on one year's notice. This arrangement would give a lessee sufficient time to establish its operation, develop a clientele, and amortize its investment in equipment and alterations, while allowing the district to regain possession of the school if enrollment trends reversed.

Next we had to establish the minimum bids. Having never leased an entire school, we contacted a number of nearby school districts to ascertain the "going rate" for a closed school. The marketplace was woefully inconsistent. One school was leased for \$16,500 per year, while another, virtually identical in size and only 16 miles away, brought in \$160,000 per year.

Amid this great spread was a small cluster of leases in the range of \$40,000 to \$50,000 per year. We decided to set the minimum bid for our two largest schools at \$40,000, and lowered the rate to \$30,000 and \$35,000 for the remaining schools, depending on their size. Given the auction format dictated by

state law, we felt that the best strategy was to establish the minimum bids at the low end of the probable range, because competition would bid the rates up to whatever price the market perceived to be economically sound. On the other hand, if the minimum was set too high, no one would enter the bidding, and we would have to repeat the long, costly process at the lower figure.

It was clear that any likely rent would not represent a reasonable return on the value of a \$6.5 million school. The problem, of course, was that use as a school did not represent the highest and best use of the real property. Having decided not to sell the sites, the school district would have to be content with a minuscule return on these assets.

As noted earlier, any lessee would have to obtain a new conditional use permit from the city before beginning operations. We therefore provided for a rent-free period of up to 120 days, starting from the acceptance of the bids, to allow the lessees time to obtain the necessary permits.

Writing the lease

Having established the major parameters, the next step was to develop a lease document incorporating these features, in addition to the numerous minor details and boilerplate that characterize any long-term lease.

The school district had several varieties of standard leases, but none that was adequate for this purpose. A form lease used for renting out a school auditorium for one evening does not begin to address issues that will arise when a lessee occupies an entire campus for ten years.

We obtained examples of long-term leases from a number of sources. Our own files contained lease documents drafted by lessors' attorneys in situations where the school district leased private property for use as warehouses, offices, etc. Several other school districts supplied copies of the leases they had use in leasing out their closed schools.

Finally, we found an excellent resource in the "Standard Industrial Lease" copyrighted by the American Industrial Real Estate Association. Although a school has little in common with a factory, the industrial lease was useful for two reasons: first, because it