
PUBLIC SECTOR PERSPECTIVES REVISITED

by John J. Hentschel, CRE

In September, 1993, The Counselors of Real Estate, in cooperation with *City & State*, a state and local government trade periodical, published a survey of public sector real estate policies and practices which was authored by this writer.

Since then, the economy has reversed, the stock market has boomed, and many local governments (which at that time were literally on the brink), now enjoy a healthy dose of fiscal prosperity with many reporting surpluses and financial windfalls.

Has time and changing economic conditions significantly altered the perspectives, policies, and procedures of public sector real estate practitioners?

In this article, the writer presents commentary and opinions on the topic based on anecdotal evidence from his personal experience as a public sector counselor, as well as empirical evidence based on a review of the results of an update to The Counselor's 1993 survey, this time conducted by MBIA Associates Consulting Inc./Bartram & Cochran in conjunction with another government trade publication, *American City and County*.

ABOUT THE AUTHOR

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SURVEY RESULTS - A COMPARISON

While it is difficult to assess the level of respondents who participated in both surveys, the data suggests that responses to each were skewed in favor of local governments (73 percent in 1993 versus 86 percent in 1998). A higher percentage of respondents (66 percent compared to 35 percent previously) now report that real estate activities are a centralized versus decentralized function. Together with other factors observed from the survey data, this trend connotes a heightened awareness of real estate's potential to impact a local government's operating

budget performance. It is probably also a reflection of the downsizing which resulted from the period of fiscal austerity experienced by local governments earlier in the decade.

Information regarding the types of services performed (and whether by in-house staff or private contractors) were generally consistent with the 1993 results in most categories, as illustrated in *Exhibit 1*.

Both surveys asked respondents to indicate (in separate questions) if the services listed were being performed by government employees or were outsourced. In-house and outsourced responses for each survey year were totaled in an effort to calculate the percentage of responding jurisdictions which performed the function.

The overwhelming propensity to buy, sell, and operate real property using government employees rather than private contractors is evident from the data. While in many instances it is a logical decision

considering the on-going nature and extent of government real estate activity, it may also be as much attributable to established staffing patterns protected by merit or civil service systems, and/or a remnant of an antiquated political patronage practice (especially with regard to building operation and maintenance). Only six percent of respondents in 1998 reported that building operation and management was outsourced. Although theoretically, economies of scale and lower costs should ensue when large-scale, multiple building owners self-manage portfolios of geographically clustered properties with internal staff, the writer has observed that such is not always the result in public sector settings. Obtuse management and accounting practices, together with rigid procurement and budgetary systems, can often elevate operating costs above those of privately owned and managed structures.

While management information systems capable of tracking utilization and expenses on a per building (versus lump sum) basis, operating in tandem with

Exhibit 1

Services In-house vs. Outsourced						
	% Respondents Performing In-house		% Respondents Outsourcing		Total of Respondents In-house + Outsourced	
	1993	1998	1993	1998	1993	1998
<i>Building Management</i>	86%	94%	8%	6%	94%	102%
<i>Property Inventories</i>	89%	98%	11%	2%	100%	100%
<i>Sales/Dispositions</i>	73%	95%	8%	5%	81%	100%
<i>Leasing</i>	68%	79%	11%	11%	79%	100%
<i>Market Research</i>	32%	37%	27%	53%	59%	90%
<i>Loan Resolution</i>	32%	55%	3%	37%	35%	92%
<i>Joint Ventures</i>	32%	57%	3%	11%	35%	68%
<i>Construction Management</i>	68%	42%	35%	51%	103%	93%
<i>Appraisal/Valuation</i>	43%	12%	78%	69%	121%	81%
<i>Purchases/Acquisition</i>	86%	84%	24%	16%	110%	100%
<i>Site Assemblage</i>	73%	78%	5%	12%	78%	90%
<i>Dev. Feasibility Analysis</i>	57%	38%	38%	51%	95%	89%
<i>H&B Use Analysis</i>	57%	41%	27%	50%	84%	91%
<i>Strategic Decision Analysis</i>	38%	77%	5%	13%	43%	90%
<i>Architectural/Design</i>	30%	8%	62%	76%	92%	84%
<i>Adaptive Reuse</i>	not avail.	61%	not avail.	not avail.	not avail.	not avail.
<i>Planning</i>	not avail.	81%	not avail.	9%	not avail.	not avail.
<i>Tax Appeal Defense</i>	not avail.	67%	not avail.	23%	not avail.	not avail.

Exhibit 2

Property Disposition Methods					
	1993	%		1998	%
	Rank	Responding		Rank	Responding
<i>Solicitation of Proposals</i>	1	62%	<i>Solicitation of Proposals</i>	1	97%
<i>Sealed Bid</i>	2	59%	<i>Advertising & Sales</i>	2	96%
<i>Public Auction</i>	3	46%	<i>Sealed Bid</i>	3	95%
<i>Ground Leases</i>	4	43%	<i>Ground Leases</i>	3	95%
<i>Advertising/Sales by Staff</i>	5	32%	<i>Private Real Estate Practitioner</i>	4	94%
<i>Joint Venture</i>	6	22%	<i>Public Auction</i>	5	91%
<i>Listing w/Real Estate Broker</i>	7	8%	<i>Listing w/Real Estate Broker</i>	5	91%
<i>Private Real Estate Practitioner</i>	7	8%	<i>Joint Venture</i>	6	83%

uniform accounting methods compatible with those used in the private sector is essential to meaningful performance comparisons; often the motivation and incentive to carry out such comparisons are absent.

Although property acquisition was performed internally by 84 percent of current respondents versus 86 percent in 1993, the number of properties acquired averaged a paltry 6.8 per year. Although an obvious candidate for outsourcing with so few acquisitions, hopefully staff responsibilities were diversified to include other tasks. Unfortunately, neither survey measured the number of in-house real estate employees or the scope of their activities.

As in 1993, sales and leasing activities seldom appear to be outsourced, a finding bolstered by responses presented in *Exhibit 2*. While significantly exceeding the percentage levels reported in 1993, the rankings are generally consistent with the prior survey, dominated by activities typically conducted by in-house staff.

Responses concerning the preparation of Development Feasibility and Highest and Best Use Analyses indicate a reversal from 1993 results to a function which is now predominantly outsourced by respondents. The reported incidence of strategic decision analyses, (*i.e.* the evaluation and comparison of the net present benefits from alternative courses of action), has doubled since 1993, with most respondents opting to perform the task internally. Joint-venture activity has doubled the level reported in 1993 to a response total of 68 percent (an activity performed almost exclusively in-house according to the survey). However, joint-ventures are ranked

last not only in the services performed category, but as a preferred disposition method as well. This seems incongruous when capital scarcity is the most significant real estate issue reported in both the 1993 and 1998 surveys (*see Exhibit 3*). Such apparent reluctance to employ joint-venture structures may reflect legislative or organizational prohibitions against equity holdings in general or such enterprises in particular, or a fear that such arrangements may present an appearance of impropriety.

The 1998 survey notes a higher incidence of market research activities, suggesting that government officials are becoming more concerned about the marketability of prospective ventures in which they choose to participate than in the past. While the increase in reported loan resolution activities may be the result of a higher loan default ratio, it may also represent a heightened propensity by government agencies to seek recovery and restitution when defaults occur, or merely reflect a respondent pool that could have been more active in the lending arena than those in the previous survey.

Each survey asked respondents to rank a list of real estate issues in their order of significance to the jurisdiction. Respondents had the ability to specify additional issues not contained within the pre-printed selections. Asset and Facility Management has leaped from a rank of fourth in 1993, to a tie as the leading issue in terms of significance reported by this year's respondents. Although recreation and parks was a very low priority in 1993 (ranked next to last in most significant issues and third among those reported as least significant) it has emerged as the other leading category in 1998. Its

Importance of Types of Development

Type of Development	1993 Rank	% Response #1 or #2		1998 Rank	% Response #1 or #2
Industrial Development	1	76%	Recreation & Parks	1	64%
Community Development	2	71%	Affordable Housing	2	58%
Affordable Housing	3	55%	Community Development	3	56%
Transit Oriented Development	4	8%	Industrial Development	4	51%
Recreation & Parks	5	7%	Airport	5	31%
Airport	6	0%	Transit Oriented Development	6	28%

Significance of Real Estate Issues (1993) Factors Influencing Real Estate Function (1998)

	1993 Rank	% Respond Above Avg.		1998 Rank	% Respond Above Avg.
Capital Constraints	1	89%	Capital Constraints	1	81%
Environment Preservation	2	69%	Asset/Facility Management	1	81%
Lack of Reuse Strategies	3	55%	Lack of Land Restricting Growth	2	44%
Asset/Facility Management	4	50%	Environmental Preservation	3	38%
Restricting Growth	5	46%	Oversupply of Distressed Prop.	4	36%
Restrictive Federal Funding	6	43%	Lack of Reuse Strategies	5	19%
Oversupply of Distressed Prop.	7	36%			

Economic Development Initiatives

Category	1993 Rank	% Responding		1998 Rank	% Responding
Tax Abatement	1	49%	Parking Subsidies	1	70%
Infrastructure Contribution	1	49%	Site Assemblage	1	69%
Tax Increment Financing	2	43%	Own/Operate Business Parks	2	65%
Site Assemblage	2	43%	Land Subsidies	3	59%
Land Subsidies	3	30%	Small Business Incubators	3	59%
Own/Operate Business/Ind. Pks.	4	24%	Tax Abatements	4	59%
Loans to Business Developers	5	19%	Rent Occupancy Cost Subsidies	5	53%
Enterprise Zone Tax Credits	5	19%	Infrastructure Contribution	5	53%
Parking Subsidies	6	14%	Tax Incentive Financing	6	50%
Home Mortgages	7	11%	Enterprise Zone/Tax Credits	7	46%
Small Business Incubators	7	11%	Loans to Business/Developers	8	35%
Venture Capital-Seed Funding	8	8%	Home Mortgages	9	30%
Rent/Occupancy Cost Subsidies	9	5%	Venture Capital/Seed Funding	10	25%
			Training Subsidies	11	23%

significance is bolstered by its ranking as last among those issues indicated by respondents as being least important. The reason for this substantial change is unclear from the data. Also notable among this year's results is the decline by almost half of those respondents listing environmental preservation as their number one or number two significant issue. The responses for community development, affordable housing, and airport development were consistent with those reported in 1993.

The responses to Transit Oriented Development as a significant issue in both 1993 and 1998 surveys are puzzling. Traffic congestion and suburban sprawl plague many metropolitan areas and are each hot issues among the planning community. "Smart Growth" initiatives which propose to direct new growth to areas of existing development, are proliferating in many areas of the country. Nonetheless, transit-oriented development remains at the bottom of the list of issues considered to be most significant and high on the list of those issues considered least significant. This may be attributable to the characteristics of those jurisdictions responding or the specific responsibilities of the personnel who completed the survey.

In terms of economic development initiatives, parking subsidies have emerged with the largest gain since 1993, increasing from a near bottom rank of 14 percent to a virtual tie with site assemblage as the top ranked initiative with a 70 percent response. While this may again be a reflection of the characteristics of the respondents (jurisdictions as well as personnel) it may also demonstrate an escalating competition to capture jobs and revenues between Central Business Districts and suburban business, shopping, and entertainment centers, each of which offer ample amounts of convenient, free parking. Other categories posting large gains as preferred economic development incentives include rent/occupancy subsidies, the operation of small business incubator facilities, and the number of jurisdictions which own and operate business/industrial parks. Although not totally conclusive, the ascendance of these incentive categories suggests that, since private capital is currently plentiful, local governments may be shifting focus away from initiatives designed to produce new buildings toward those encouraging and supporting job creation or retention.

ANECDOTAL EXAMPLES

Supplementing the empirical evidence represented by the survey update is the writer's anecdotal

observations that public officials and executives are experiencing a genuine epiphany regarding the deployment of public real estate assets.

For example, in August 1995, the Maryland Secretary of Transportation assembled a Real Estate Advisory Group (REAG). The group was composed of distinguished Maryland real estate practitioners among which included this writer and Mahlon "Sandy" Apgar, CRE, who served as the group's chairman. Working closely with senior management of each of the Maryland Department of Transportation's (MDOT) Modal Administrations (e.g. Port, Highway, Aviation, Motor Vehicle, and Mass Transit, as well as the Toll Authority), the REAG was charged with:

1. Redefining the role of real estate within MDOT's mission;
2. Recommending property utilization practices which encouraged the strategic deployment of MDOT assets to create economic development opportunities;
3. Formulating criteria and methods to be employed in the evaluation of public capital investments.

After one year of deliberations, REAG published its report. Among its recommendations were:

- Procedures to enhance public sector real estate management practices;
- An outline for the creation and maintenance of a viable real property management information system;
- An on-going, systematic process to periodically assess the utility of MDOT's portfolio of more than 7,000 properties;
- A redefinition of the concept and methods of computing the value of MDOT's real estate assets in use and as part of economic development initiatives.

Subsequent to chairman Apgar's testimony before the Governor and his cabinet, MDOT Secretary Winstead established a central real estate unit in his office to coordinate implementation of the REAG recommendations and the utilization of MDOT property within each Modal Administration. During a recent presentation to REAG members, Secretary Winstead presented numerous tangible examples illustrating MDOT's assimilation and implementation of REAG's recommendations.

A product of the REAG process, the Mass Transit Administration has recently solicited the services of a private real estate advisor for a multi-year

contract to assist in the evaluation and structure of transit-oriented development opportunities employing MTA real estate assets.

Other examples of this trend in the writer's market area include Baltimore City Community College's current solicitation for real estate advisory services to guide its structuring of a development agreement concerning a parcel overlooking Baltimore's Inner Harbor, as well as Baltimore Development Corporation's recent decision to engage a private firm to market and manage all of the business and industrial parks and properties under the control of this city's economic development agency.

CONCLUSION

Empirical and anecdotal evidence clearly indicates that the public sector has become more aware of, sensitive to, and sophisticated about its real estate activities than in the past.

When buying, selling, or operating property, government executives still exhibit a "do it yourself" proclivity according to the survey, occasionally soliciting a little help from their friends in the private sector.

While capital to fund real estate projects is generally reported to be ample in private sector surveys, its dearth apparently continues to plague public executives enough to sustain its ranking as the most significant real estate issue identified. This may, however, be partly the result of a political budgetary process which is constrained by an inherent reluctance to raise taxes which might incite constituent anger or trigger local employers to search for greener pastures. Capital scarcity may also be a response to the elevated risks associated with economic and community development projects that typically require government, as lender/investor of last resort, to fund those gaps conventional sources are unable or unwilling to fill. The response may also reflect the public sector's incessant desire to satisfy constituent service demands and fund area economic expansion, both of which fuel a voracious appetite for capital. Counselors capable of devising creative funding mechanisms to satisfy this hunger will always find a welcome seat at the table of a grateful host who will never be full!

The ascent of asset and facility management to the pinnacle of significant real estate issues reported is an important step on the path toward the public sector's respect for and understanding of real estate as an asset class.

Counselors who can be tolerant of and patient with the idiosyncrasies of bureaucracy, (including arcane competitive bidding and equal opportunity contracting processes); those who can effectively communicate the benefits of outsourcing; and those who can be as adept at practicing the art of statesmanship as they are the craft of real estate, should anticipate an expanding market for their services within the public sector as the millennium unfolds.^{REI}

ABOUT THE AUTHOR (continued from page 9)

Hentschel previously served as Real Estate Officer of Baltimore City during three mayoral administrations. Hentschel authored *The Counselors'* original "1993 Government Real Estate Management Survey," was a contributing editor for the 1995 Real Estate Issues focus edition, "The Impact of Government and Politics on Real Estate," and was coordinator of *The Counselor's* 1993 symposium - "Real Estate Solutions for Government."

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