REAL ESTATE ISSUES

THE COUNSELORS OF REAL ESTATE™
http://www.cre.org/

FALL 1998
Volume 23, Number Three

Focus Edition:
PUBLIC SECTOR COUNSELING

ABOUT THE COUNSELORS OF REAL ESTATE™

The Counselors of Real Estate, established in 1953, is an international group of high profile professionals including members of prominent real estate, financial, legal and accounting firms as well as leaders of government and academia who provide expert, objective advice on complex real property situations and land-related matters.

Membership is selective, extended by invitation only on either a sponsored or self-initiated basis. The **CRE Designation** (Counselor of Real Estate) is awarded to all members in recognition of superior problem solving ability in various areas of specialization such as litigation support, asset management, valuation, feasibility studies, acquisitions/dispositions and general analysis.

CREs achieve results, acting in key roles in annual transactions and/or real estate decisions valued at over $41.5 billion. Over 300 of the Fortune 500 companies retain CREs for advice on real estate holdings and investments. CRE clients include public and private property owners, investors, attorneys, accountants, financial institutions, pension funds and advisors, government institutions, health care facilities, and developers.

Enrichment Through Networking, Education & Publications

Networking continues as the hallmark of The Counselor organization. Throughout the year, programs provide cutting-edge educational opportunities for CREs including seminars, workshops, technology sessions, and business issues forums that keep members abreast of leading industry trends. Meetings on both the local and national levels also promote interaction between CREs and members from key user groups including those specializing in financial, legal, corporate, and government issues.

CRE members benefit from a wealth of information published in The Counselors' tri-annual award-winning journal *Real Estate Issues* which offers decisive reporting on today's changing real estate industry. Recognized leaders contribute critical analyses not otherwise available on important topics such as institutional investment, sports and the community, real estate ethics, tenant representation, break-even analysis, the environment, cap rates/yields, REITs, and capital formation. Members also benefit from the bi-monthly member newsletter, *The Counselor*, and a wide range of books and monographs published by The Counselor organization. A major player in the technological revolution, the CRE regularly accesses the most advanced methodologies, techniques and computer-generated evaluation procedures available.

What is a Counselor of Real Estate (CRE)?

A Counselor of Real Estate is a real estate professional whose primary business is providing expert advisory services to clients. Compensation is often on an hourly or total fixed fee basis, although partial or total contingent fee arrangements are sometimes used. Any possibility of actual or perceived conflict of interest is resolved before acceptance of an assignment. In any event, the Counselor places the interests of the client first and foremost in any advice provided, regardless of the method of compensation. CREs have acquired a broad range of experience in the real estate field and possess technical competency in more than one real estate discipline.

The client relies on the counselor for skilled and objective advice in assessing the client's real estate needs, implying both trust on the part of the client and trustworthiness on the part of the counselor.

Whether sole practitioners, CEOs of consulting firms, or real estate department heads for major corporations, CREs are seriously committed to applying their extensive knowledge and resources to craft real estate solutions of measurable economic value to clients' businesses. CREs assess the real estate situation by gathering the facts behind the issue, thoroughly analyzing the collected data, and then recommending key courses of action that best fit the client's goals and objectives. These real estate professionals honor the confidentiality and fiduciary responsibility of the client-counselor relationship.

The extensive CRE network stays a step ahead of the ever-changing real estate industry by reflecting the diversity of all providers of counseling services. The membership includes industry experts from the corporate, legal, financial, institutional, appraisal, academic, government, Wall Street, management, and brokerage sectors. Once invited into membership, CREs must adhere to a strict Code of Ethics and Standards of Professional Practice.

Users of Counseling Services

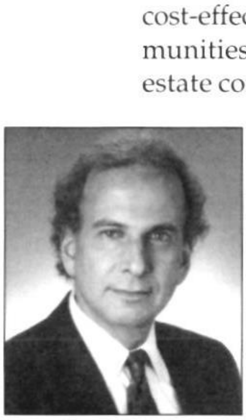
The demand continues to increase for expert counseling services in real estate matters worldwide. Institutions, estates, individuals, corporations and federal, state and local governments have recognized the necessity and value of a CRE's objectivity in providing advice.

CREs service both domestic and foreign clients. Assignments have been accepted in Africa, Asia, the United Kingdom, the Caribbean, Central and South America, Europe and the Middle East. CREs have been instrumental in assisting the Eastern European Real Property Foundation create and develop private sector, market-oriented real estate institutions in Central and Eastern Europe and the Newly Independent States. As a member of The Counselor organization, CREs have the opportunity to travel and share their expertise with real estate practitioners from several developing countries including Poland, Hungary, Bulgaria, Ukraine, Czech Republic, Slovak Republic, and Russia as they build their real estate businesses and develop standards of professional practice.

Only 1,100 practitioners throughout the world carry the CRE Designation, denoting the highest recognition in the real estate industry. With CRE members averaging 20 years of experience in the real estate industry, individuals, institutions, corporations, or government entities should consider consulting with a CRE to define and solve their complex real estate problems or matters. REI

Public Sector Counseling... A Compelling CRE Environment

Historically, the public sector has focused increasingly on its real estate assets for the purposes of preserving open space, generating and maximizing capital and profits from the sale/joint-venture of underutilized and surplus assets and through cost-effective debt financing. For years, communities have enlisted the support of real estate consultants to render a wide range of services; from litigation support to quantitative and qualitative supply and demand analysis; from master planning to fee development; from debt structuring and restructuring to dispositions, acquisitions, and joint-ventures.



Today, the complexities and linkages of the worldwide markets have necessitated an adjustment in the courses of action that the public sector employs to outsource its real estate requirements. The theme is specialization in tandem with the highest level of competency in the respective specialized area, in order to accommodate the current and emerging market-driven challenges placed on communities.

The Counselors of Real Estate has never been better positioned to address public sector requirements. Our members have earned "top flight" advanced degrees in architecture, business, urban planning, public administration, and economics, among others. More important, CREs are applying their formal educational base with years of seasoned professional expertise to provide communities with skilled due diligence services and transactional implementation programs. Complex changes in the domestic and global financial markets have dictated that the public sector retain market responsive expertise to raise and package debt and equity and initiate private/public partnerships. CREs continue to be at the forefront of these engagements and are recognized as "market makers" and "market leaders."

The articles in the current edition of *Real Estate Issues* reflect some of the important roles that CREs are playing in the public sector. A read-through of this issue will, no doubt, validate why members of The Counselors of Real Estate continue to be held in the highest regard and serve as an incomparable resource to the public sector.

Steven D. Leader

Steven D. Leader, CRE
1998 President
The Counselors of Real Estate

REAL ESTATE ISSUES

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DEPARTMENTS

ADVERTISER'S INDEX

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GOVERNMENTS SELECTIVELY PRIVATIZING REAL ESTATE MANAGEMENT

Maura M. Cochran, CRE

Outsourcing of services has become a way of life in the private sector. But to what extent has the public sector decided to outsource or privatize real estate functions? Have the results of outsourcing been satisfactory? To answer these questions and more, *American City and County* and MBIA & Associates Consulting/Bartram & Cochran recently conducted a survey and interviewed key federal, state, and local government staff and vendors. Here, the author presents key findings of the 1998 survey, as well as a comparison to a similar poll conducted five years ago by John Hentschel, CRE, *(page 9)*.

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PUBLIC SECTOR PERSPECTIVES REVISITED

John J. Hentschel, CRE

In September 1993, The Counselors of Real Estate, in cooperation with *City & State* Magazine, conducted and published a "Government Real Estate Management Survey" to ascertain the nature and extent of public sector real estate policies and practices. Since then, the economy has reversed, the stock market has boomed, and many local governments which at the time were literally on the brink, are now enjoying a healthy dose of fiscal prosperity with many reporting surpluses and financial windfalls. Here, the writer who authored the 1993 survey revisits the topic, presenting commentary and opinions based on anecdotal as well as empirical evidence.

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AFFORDABLE HOUSING THROUGH NON-PROFIT/PRIVATE-PUBLIC PARTNERSHIPS

Rocky Tarantello, CRE, & John Seymour

The increase in demand for affordable housing and limited public funding has created a growing need for the formation of non-profit/private-public partnerships. The Southern California Housing Development Corporation is an extraordinary example of a private non-profit corporation, which has successfully acquired and rehabilitated over 2,500 units. This article presents several key prerequisites for a strong non-profit housing provider and possible sources for required debt and equity capital to finance the "typical" affordable housing project.

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UNDERSTANDING THE TAX BASE CONSEQUENCES OF LOCAL ECONOMIC DEVELOPMENT PROGRAMS

Richard K. Gsottschneider, CRE

The purpose of this article is to discuss the concept of tax base management from the perspective of a municipality, and to illustrate how tax base management and economic development can have conflicting goals in an urban or suburban environment, unless properly managed. For public sector officials, it is important to recognize the potential for a conflict between two distinct, and yet potentially overlapping areas of municipal concern, and to establish procedures to achieve the proper balance in this regard.

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Forging a New Partnership: the Real Estate Professional and the Not-For-Profit World

Richard S. Stanson,CRE, & Myra R. Karse

At the end of 1993, there were more than a million not-for-profit organizations, all of which have one thing in common: each would welcome increased income even while finding it increasingly difficult to garner a larger share of the public's dollars. One method is to foster real estate gifts as an additional revenue stream. This article discusses ways to successfully bridge the gap between the not-for-profit world and the real estate professional.

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Privatizing Today's Public Housing

Philip A. Hickman, CRE

This article 1). provides a national overview of the "public housing business;" 2). summarizes the major structural changes resulting in the privatization of the management and redevelopment of public housing; and 3). describes The Habitat Company's redevelopment experience of a major public housing property in Chicago. The "public housing business" is undergoing dramatic changes and the time and talents of market-oriented real estate professionals, especially CREs, are needed in this process of community building.

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CREs & Non-Profits: Counseling Denominational & Educational Entities in Today's Changing Real Estate Environment

Frank J. Parker, CRE, & Alanna McKiernan

A number of significant non-profit organizations find themselves in situations where their real estate assets exceed their current obligations. As a result, they and those who advise them, must take steps to rectify this dilemma. This manuscript discusses the role of non-profit institutions, highlighting some of the present conditions facing them (in particular, denominational and educational entities). The authors detail some of the many options available to non-profits regarding their real estate requirements and how CREs can play an important role in helping many of these institutions.

CONTRIBUTOR INFORMATION

Real Estate Issues publishes four times annually (Spring, Summer, Fall, Winter). The journal reaches a lucrative segment of the real estate industry as well as a representative cross section of professionals in related industries.

Subscribers to *Real Estate Issues (REI)* are primarily the owners, chairmen, presidents, and vice presidents of real estate companies, financial corporations, property companies, banks, management companies, libraries, and REALTOR® boards throughout the country; professors and university personnel; and professionals in S&Ls, insurance companies, and law firms.

Real Estate Issues is published for the benefit of the CRE (Counselor of Real Estate) and other real estate professionals, planners, architects, developers, economists, government personnel, lawyers, and accountants. It focuses on providing up-to-date information on problems and topics in the field of real estate.

REVIEW PROCESS

Readers are encouraged to submit their manuscripts to:
Real Estate Issues, c/o The Counselors of Real Estate, 430 North Michigan Avenue, Chicago, Illinois 60611. All manuscripts are reviewed by three members of the editorial board with the author's name(s) kept anonymous. When accepted, the manuscript and any recommended changes is returned to the author for revision. If the manuscript is not accepted, the author is notified by letter.

The policy of *Real Estate Issues* is not to accept articles that directly and blatantly advertise, publicize, or promote the author or the author's firm or products. This policy is not intended to exclude any mention of the author, his/her firm or their activities. Any such presentations however, should be as general as possible, modest in tone, and interesting to a wide variety of readers. Potential conflicts of interest between the publication of an article and its advertising value should also be avoided.

Every effort will be made to notify the author on the acceptance or rejection of the manuscript at the earliest possible date. Upon publication, copyright is held by The Counselors of Real Estate (American Society of Real Estate Counselors). The publisher will not refuse any reasonable request by the author for permission to reproduce any of his/her contributions to the journal.

DEADLINES

See Editorial Calendar on page 48 for deadlines.

MANUSCRIPT/ILLUSTRATIONS PREPARATION

1. Manuscripts **must be submitted on disk** (along with hard copy) in **IBM or PC format only--Mac files cannot be accommodated**: .txt (text) file format or Word for Windows 6.0. All submitted materials, including abstract, text and notes, are to be **double-spaced** on one side only per sheet, with wide margins. Number of manuscript pages is not to exceed 15. **Submit five copies of the manuscript accompanied by a 50- to 100-word abstract and a brief biographical statement. Computer-created charts/tables should be in separate files from article text.**
2. All notes, both citations and explanatory, are to be numbered consecutively in the text and placed at the end of the manuscript.
3. Illustrations are to be considered as figures, numbered consecutively and submitted in a form suitable for reproduction. (Camera-ready form, line screen not to exceed 80 dots per inch-DPI.) If higher DPI is warranted to show greater image blends or contrast, illustrations must be computer-generated as PC compatible using the following formats: QuarkXPress, PageMaker, Illustrator, Photoshop, Corel Draw. Any other formats will not be accepted.
4. Number all tables consecutively. All tables are to have titles.
5. Whenever possible, include glossy photographs to clarify and enhance the content in your article.
6. Article title should contain no more than six words including an active verb.
7. For uniformity and accuracy consistent with our editorial policy, refer to the style rules in *The Chicago Manual of Style*.

THE BALLARD AWARD MANUSCRIPT SUBMISSION INFORMATION

The *REI Editorial Board* is accepting manuscripts in competition for the 1998 William S. Ballard Award. All articles published in *REI* during the 1998 calendar year will be eligible for consideration, including member and non-member authors. The $500 cash award and plaque is presented annually each spring, during The Counselors' Midyear Meetings to the author(s) whose manuscript best exemplifies the high standards of content maintained in the journal. The recipient is selected by a three-person subcommittee comprised of members of The Counselors of Real Estate. (The 1998 recipient will be honored at The Counselors 1999 Midyear Meetings in Seattle.)

EDITOR'S STATEMENT

Land use has long been a key element of public policy. Government continually seeks to achieve a balance between economic growth and quality of life, private development and open space, revitalization of decaying neighborhoods and wholesale class displacement. Embarcadero Center in San Francisco, Lincoln Center in New York, the L'Enfant Plaza area of Washington, D.C., Harborplace and Camden Yards in Baltimore, and the new Denver airport are some of the better known public policy achievements over the past 40 years.

The public sector spends billions of dollars annually in advisory fees and consulting studies. The recent trend toward privatization represents an additional opportunity for real estate professionals of varying disciplines to provide advice to public sector clients in areas such as municipal finance, development, planning, economic feasibility, asset disposition, and tax policy. The need for such services will increase in the new Millennium as the world moves toward globalization.

In recognition of such phenomena, the Fall issue of *Real Estate Issues* is dedicated to public sector counseling with articles ranging from tax base management to public housing. You may find the first two articles of particular interest as they reference each other.

In 1993, The Counselors of Real Estate and *City & State* Magazine published a survey to determine the nature and extent of public sector real estate policies and practices. In 1998, a similar poll has been conducted, this time a joint-venture between MBIA & Associates Consulting/Bartram & Cochran and *American City and County*. The first article in this issue by Maura Cochran, CRE, presents key findings from the 1998 survey and compares them to the 1993 results. In the next article, John Hentschel, CRE, author of the 1993 survey, presents his interpretations of the comparisons based on anecdotal and empirical evidence.

Richard Marchitelli, CRE
Co-editor in chief

Governments Selectively Privatizing Real Estate Management

by Maura M. Cochran, CRE

Outsourcing of services has become a way of life in the private sector. But to what extent has the public sector decided to outsource or privatize real estate functions?. . .What services are better handled externally? . . . Are large or small firms the winners of these contracts?. . . Have the results of outsourcing been satisfactory? To determine these answers, *American City and County* and MBIA & Associates Consulting/Bartram & Cochran recently conducted a survey and interviewed key federal, state, and local government staff and vendors.

While a municipality's real estate function is usually among its largest sources of assets and costs, management of this area runs the gamut from a highly centralized function to one that is largely ignored. Overall however, appreciation for the importance of real estate – as well as the need to carefully utilize both internal and external resources in its management – appears to be increasing.

Results of the survey, particularly when compared to a similar poll conducted five years ago by John Hentschel, CRE, *(see article page 9)*, show that governments are bringing in-house the capability to handle the regularly occurring, day-to-day real estate functions such as strategic decision analysis and joint ventures. At the same time, many governments continue to rely on external expertise where appropriate.

Highlights of the survey results include:

- Forty percent of the respondents said that the importance of the real estate function had increased in the last year, compared with only six percent who reported a decline.
- Sixty-six percent said that real estate management was centralized, a structure that appears to allow for a better strategic focus.

ABOUT THE AUTHOR

Maura Cochran, CRE, SIOR, *is a principal of MBIA & Associates Consulting / Bartram & Cochran, a national real estate consulting firm based in Hartford, Connecticut, that specializes in public / private sector consulting.*

- Only eight percent of the respondents reported privatizing all or part of their real estate management function in the last year.
- Services outsourced typically involved tasks that were shorter in duration, where adding staff was not justified.

The survey had 90 respondents representing some of the largest cities in the country as well as some of the smallest jurisdictions. Additionally, interviews were conducted with 11 state agencies that had not responded to the survey. Results were compared to a similar 1993 poll conducted by *City & State* Magazine and The Counselors of Real Estate – showing a dramatic change in how services are handled over that time.

As seen in *Figures 1 & 2*, the trend toward outsourcing continued in some areas. The sharpest changes over the last five years were:

Figure 1

Services Outsourced by Local Government

	1993	1998	Point Change
Construction Management	68%	24%	(44%)
Appraisal / Valuation	43%	12%	(31%)
Architectural & Design Services	30%	8%	(22%)

By contrast, there was a strong trend to bring the following in-house:

Figure 2

Services Handled Internally by Local Government

	1993	1998	Point Change
Strategic Decision Analysis	38%	72%	(34%)
Loan Resolution	32%	55%	(23%)
Joint Ventures	32%	50%	(18%)
Sale / Disposition	73%	89%	(6%)

Other changes over the last five years include:

- Funding availability was cited as the most important factor influencing real estate management – by 53 percent of the respondents, compared to 46 percent in 1993.
- Respondents identifying asset and facilities management as the most important factor increased from nine percent to 24 percent.
- The importance of environmental preservation identified as a major concern has fallen from 30 percent to 12 percent.

LOCAL GOVERNMENT HAS CHANGED SELECTION PROCESS

Five years ago, a plurality of jurisdictions responding selected consultants from a list of pre-qualified firms. In the chart labeled **"Method of Selecting Counselor of Real Estate"** *(located on the "Summary of Survey Results," page 8)*, shows that municipalities now look almost equally to advertised public bid, sole source selection, and pre-qualified firms. Respondents who were interviewed explained that the biggest shift was that vendors who were on the pre-qualified list have now become their service providers.

This trend toward forming long-term relationships with vendors is rooted in increasing efficiency. Not only are the municipalities likely to obtain better pricing, they are getting a shorter learning curve from a better-prepared vendor.

WHAT THEY DON'T KNOW CAN HURT THEM

One surprise in the 1998 survey responses was the frequent inability of respondents to provide information on the value of real estate, the number and types of property, annual leasing costs, or management method. It goes without saying that someone who does not even know the contents of the attic is unable to evaluate how valuable they might be. Nearly a third of respondents failed to provide an estimate of their holdings or leasing costs.

STATE GOVERNMENTS ARE OUTSOURCING THE DISPOSITION OF SURPLUS REAL ESTATE

Some states are realizing the value of their dormant assets. One asset class being examined is former mental health hospitals, now rendered obsolete by dramatic treatment changes in the field. Many of these hospitals have large campuses in strategically placed areas. Three states that are have outsourced the disposition of these facilities to real estate professionals are Massachusetts (completed), Connecticut (underway), and New York (process starting).

Bud Cohen of the State of Connecticut Office of Policy and Management (OPM) provided the following insight into the state's outsourcing the process. "Control of surplus facilities and land was under the control of the Department of Public Works (DPW). Their time frame was for short-term use; there was no strategic plan. The state therefore decided to create an Asset Management Unit comprising staff from both DPW and the OPM.

The work was divided so that OPM had oversight of inventorying and long-term planning while DPW continued its role as property managers with day-to-day control.

"The overall objective of the new committee was disposition of surplus assets. This was part of the overall plan to balance the budget. While the sale of these assets would bring in some revenue (and reduce the level of the state's bond indebtedness), the surplus assets are also expensive to mothball. Operating expenses can run in the millions."

The state decided to outsource this function because the knowledge base was specialized and the need was short-term (one to two years). It did not make sense to staff up for the assignment. A request for proposal (RFP) was sent to approximately 150 consultants and brokers. Because compensation was to be strictly on an hourly fee basis, the finalists were consultants that had no conflicts of interest. The three chosen teams were a "Big 6" firm, a regional company, and a local consulting practice. Each was assigned different assets for disposition based on each firm's specialization. Compensation is on a set hourly, not-to-exceed basis with no bonus or incentive fees.

Nine months into the process the state's experience has been that the "Big 6" firm was slower to start, due to the lengthy contract negotiations, but the firm quickly gained speed. All three teams are now on course, and the state is just starting to implement its disposition plan as of this writing.

DEPARTMENT OF DEFENSE PRIVATIZES FAMILY HOUSING

The federal government is undertaking the privatization of family housing on military posts. According to Standard & Poors's *Credit Week Municipal*, the Department of Defense (DOD) owns and operates 300,000 units of family housing for use by members of the U.S. armed forces and civilian employees. The increasing obsolescence of existing housing means that the DOD needs to replace or renovate 60 percent of these units.

DOD is soliciting proposals for privatized military family housing projects at the following bases: Lackland Air Force Base, San Antonio, Texas; Camp Pendelton, California; Fort Carson, Colorado Springs, Colorado; Marine Logistics Base, Albany, Georgia; Corpus Christi Naval Air Station, Corpus Christi, Texas; and Everett Naval Station, Everett, Washington. Fort Carson is the first base to go through the process. The award was challenged in contract court and is being re-bid.

The **REPS** generally require bidders to enter into a ground lease for land currently owned by the DOD and to either build new military housing or rehabilitate existing family housing. Selected vendors will operate the projects as rental housing by leasing the housing to service members and their families. Vendors will pay the operating expenses of the properties including utilities, administrative expenses, repairs, and maintenance. It is uncertain if the new owners will be required to pay real estate taxes; this expense may vary from location to location.

Bidders may propose that DOD guarantee or pay certain expenses of the transaction such as utility expenses or debt prepayment in the event of base closure or realignment. This is subject to negotiation on a case-by-case basis.

GENERAL SERVICE ADMINISTRATION HAS OUTSOURCING LEASE ACQUISITION

As part of the initiative to streamline the process and trim government overhead and payroll, the General Service Administration (GSA) has embarked on an ambitious initiative to outsource lease acquisition and related services to the private sector. Given the vast amount of space that the federal government leases, these are potentially very large contracts.

The GSA wanted to hire large multi-disciplinary firms that could handle the volume of business. Bonus points were given to firms that brought in minority subcontractors. The agency divided the nation into four zones and chose two vendors in each zone. Because some vendors won multiple zones, a total of five firms were chosen. They include SSC, Equis, PM Realty, Crown Partnership, and Amalang Partnership. Each firm won a three-year contract with two one-year options. Fees are based on a task-by-task basis; the contracts were awarded six months ago. In some cases the vendors will work on a contingency (brokerage) basis; other assignments will be on an hourly (consultative) basis.

Joe Delogu, vice president and director of Federal SSC, provided the following insights. The territory is the East Zone, which extends from Maine to the North Carolina border and includes Puerto Rico and the Virgin Islands. SSC has 20 full-time staff in its government services group assigned to this contract; they are joined by over 600 professionals at Colliers in their assigned territory. At this point the volume of work is not great. He attributes this to the newness of the contract managers, and a low degree of awareness at the working level. They are having a series of presentations with key staff to get the process geared up.

LESSONS LEARNED

The public sector varies widely in its approach to outsourcing and privatization. In many cases with the federal government, the rules are just becoming established early in the entrepreneurial learning curve. In some cases they are showing brilliance of thought, only to hit the reality of contaminated sites and functionally obsolete facilities.

In the survey-related follow-up interviews, officials at state governments appeared to succeed when they centralized and introduced strategic planning. In other states we could not find a person or department that knew if the state had surplus real estate. In these cases, officials have not identified real estate as an important asset class – a prerequisite for outsourcing.

In terms of privatization, the need for specific expertise – rather than a decision to outsource all or a substantial portion of the function—frequently dictates the choice. Large and small "boutique" firms regularly team up to win large assignments by combining their areas of expertise to best serve the client. This is particularly true in areas where an "MWOB" – minority and/or woman-owned business – received preference in the vendor selection. In most instances, such a preference may represent 15 percent to 25 percent of the evaluation score.

The survey data indicate that outsourcing and privatization in the public sector is a maturing process – spearheaded by a growing appreciation of the importance of managing real estate. State and federal governments have started outsourcing large contracts in the last few years. Leaders in the movement toward building capabilities for ongoing functions are the smaller states and agencies. At the same time, these entities rely heavily on outsourcing for the expertise they need, particularly in the areas where a more entrepreneurial and better-capitalized private sector can do the job. State and local governments appear to have found that private companies often have the resources, such as computer technology or attractive financing , that the municipality either does not have or cannot justify for shorter-term horizons.

In conclusion, outsourcing and privatization in the public sector has been a process that has come up from the grass roots of local government and has matured. State and Federal governments have just started large contract outsourcing in the last few years. While the jury is still out, there is a great deal of enthusiasm among those who are using this mechanism to procure services that are better done by the more entrepreneurial, and in many cases better capitalized, private sector.

(For a summary of the survey responses see pages 6-9 that follow.) REI

Survey of Real Estate Management in the Public Sector

Results

Sponsored by *American City & County* and
MBIA & Associates Consulting, Inc./Bartram & Cochran

According to the spring 1998 survey, while a municipality's real estate function is usually among its largest source of assets and costs, the management of this area runs the gamut from a highly centralized function to one that is largely ignored. Overall, however, appreciation for the importance of real estate — as well as the need to carefully utilize both internal and external resources in its managemet — appears to be increasing.

Results of the survey, particularly when compared to a similar poll conducted five years ago, show that governments are bringing in-house the capability to handle the regularly occurring, day-to-day real estate functions such as strategic decision analysis and joint ventures. At the same time, many respondents continue to rely on external expertise where appropriate.

Highlights of the survey findings include:

- ❖ 40% of respondents said the importance of the real estate function had increased in the last year, compared with only 6% who reported a decline.
- ❖ 66% said real estate management was centralized, a structure that appears to allow for better strategic focus.
- ❖ Only 8% of respondents reported privatizing either all or part of their real estate management function in the last year.
- ❖ Services outsourced typically involve tasks that are shorter in duration, where adding staff was not justified.

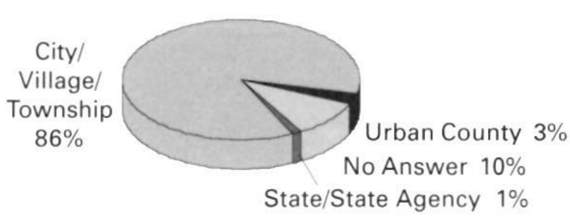
(percentages expressed throughout based on number of responses)

Profile of Respondents

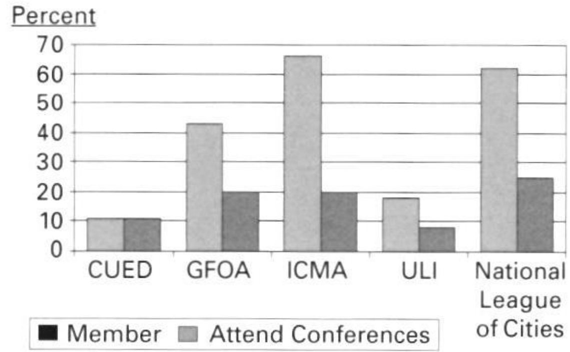
Number of Respondents 83

Average Market Value of Real Estate Owned by Municipality $97,696,170

Breakdown of Jurisdictions Responding (Average Population: 146,631)



Respondent Organizations



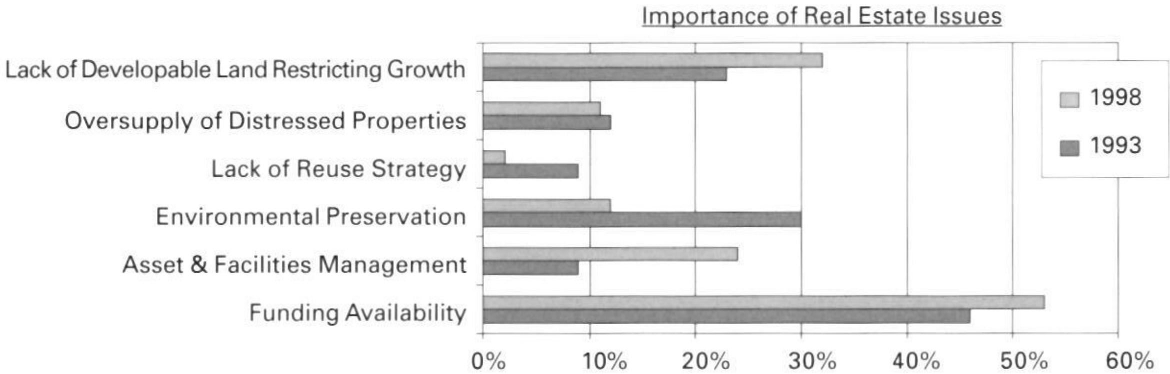
Survey Highlights

Types of real estate owned or leased (expressed in number of properties)

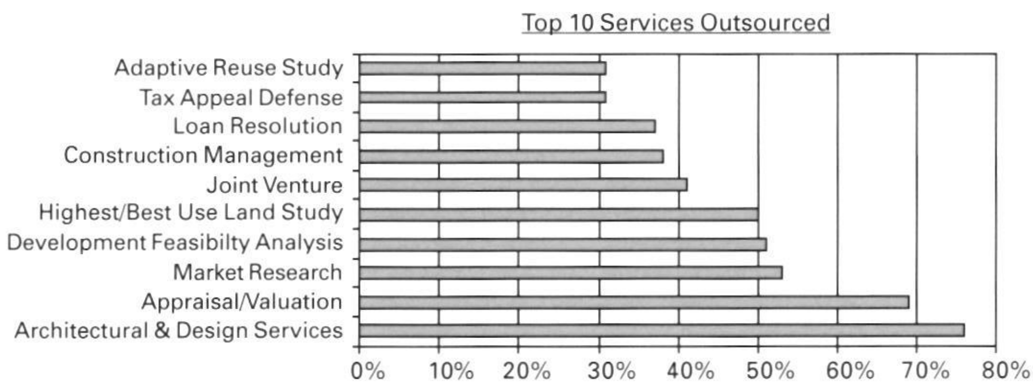
Business/industrial park	33	Recreational facility	1,306
Civic center	35	Residential	934
Historic property	46	School	37
Hospital	47	Specialized facility	554
Office space	150	Stadium/sports complex	63
Public building	451	Warehouse/storage	166
Public parking	167	Other	167

Factors influencing real estate function

* *This chart compares results from this survey with a similar poll taken five years earlier.*

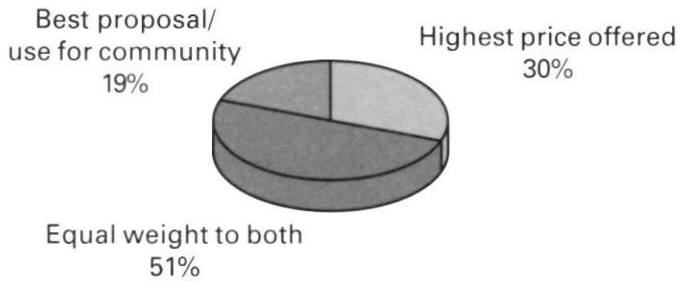


Performance of service



Real estate disposition

Most important factor for selecting purchaser of disposed property



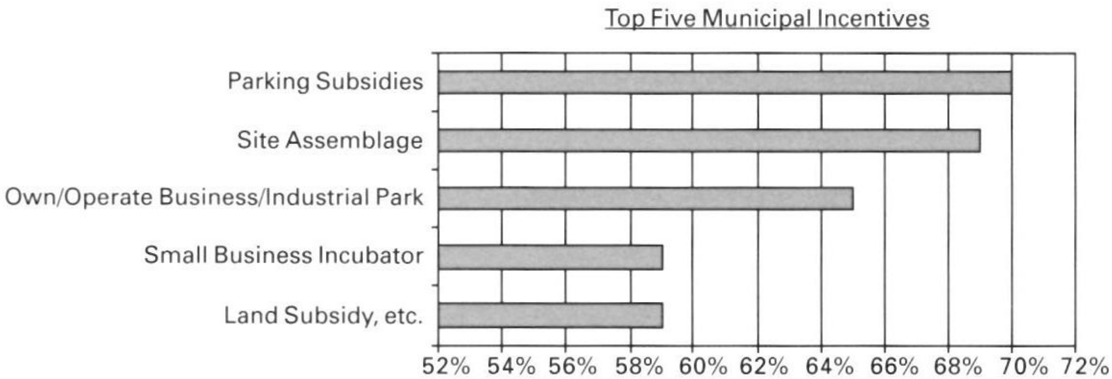
Eminent domain actions during last fiscal year

Average number of properties acquired 6.8

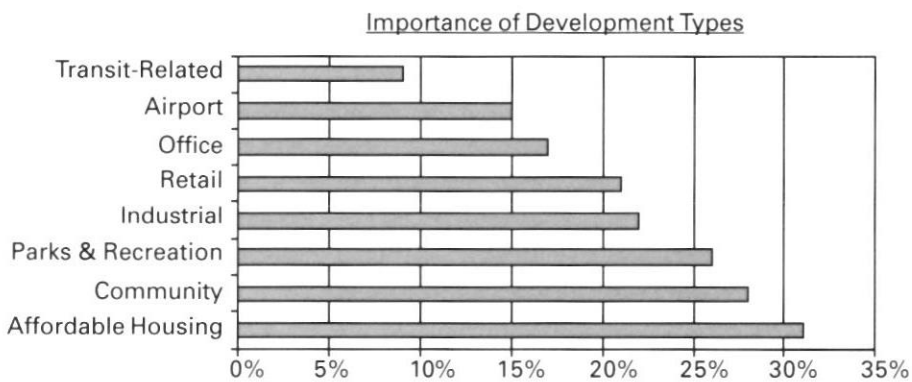
Foreclosure actions during last fiscal year

Average number of buildings 2

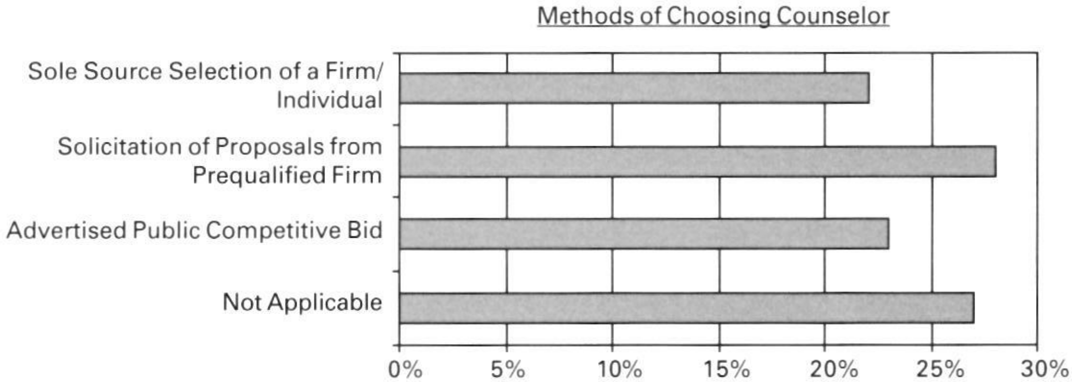
Economic development initiatives available (more than one answer possible)



Importance of types of development



Method of selecting Counselor of Real Estate (CRE)



Conclusions

The survey data indicate that outsourcing and privatization in the public sector are a gradually maturing process — spearheaded by a growing appreciation for the importance of managing real estate. State and federal governments have started large contract outsourcing in the last few years. Government at smaller levels seems to have led the way in building capabilities for ongoing functions. At the same time, these smaller governments rely heavily on outsourcing for the expertise they need, particularly in areas where a more entrepreneurial and better-capitalized private sector can do the job. State and local governments appear to have found that private companies often have the resources, such as computer technology or attractive financing, that the municipality either does not have or cannot justify for shorter-term horizons.

Maura M. Cochran, CRE, SIOR, supervised the polling and analyzed the results of this survey. She is a principal of MBIA & Associates Consulting, Inc./Bartram & Cochran. It is a national real estate consulting firm based in Hartford, Conn., with a branch office in Philadelphia, that specializes in public/private sector consulting.

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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

John Hentschel, CRE, *is founder and president of Hentschel Real Estate Services, and The Millennium Group, both Baltimore-based firms which advise public sector executives when making organizational, operational, and capital investment decisions involving real estate and economic/community development matters.*

(Continued on page 14)

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

Exhibit 2

Property Disposition Methods

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

Exhibit 3

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."*

Affordable Housing Through Non-Profit/ Private-Public Partnerships

by Rocky Tarantello, CRE, & John Seymour

In less than five years, the Southern California Housing Development Corporation (SCHDC) of Rancho Cucamonga, California, has accomplished something extraordinary. Without the benefit of initial seed capital and structured as a private non-profit 501C(3) corporation, SCHDC has acquired and rehabilitated close to 2,500 rental housing units with a current approximate market value of over $100 million and approximately $40 million in equity. What makes this accomplishment even more remarkable is that 60 percent of the units qualify as low to moderate income affordable housing and all were acquired through a series of public/private partnerships. Since this kind of success breeds success, SCHDC expects to replicate their success throughout the nation by acquiring and rehabilitating 750-1,000 additional units per year into the foreseeable future.

ABOUT THE AUTHORS

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John Seymour *is CEO of the Southern California Housing Development Corporation. He is a former United States Senator; State Senator, CA State Legislator; Mayor & Councilman, City of Anaheim. Seymour is also a past president of the CA Association of REALTORS.*

THE GROWING NEED FOR COUNSELING

Public agencies frequently engage the services of real estate counselors to assess affordable housing needs, evaluate housing market conditions, analyze joint-venture proposals and financial projections, or make a variety of other recommendations regarding the potential success of the public/private venture. Prior project failures have caused understandable skepticism, as many have become gang controlled, drug infested slums. Few have truly flourished and succeeded. Hence, limited public funds must be invested wisely as demand for affordable housing swells. Current estimates peg the nation's supply of affordable housing units at 9.4 million, down from 10.3 million in the last decade, according to the U.S. Housing & Urban Development Department (HUD). Yet as early as 1990, HUD estimated that 12.5 million renter households were in need of affordable rentals, 5.4 million of these paying 50 percent or more of their annual income for rent. The subsidized Section 8 Federal program has provided a mere 1.25 million units, 840,000 of which are under Housing Assistance Programs all scheduled to expire by the year 2003. The estimated cost to renew these subsidies is $16 billion, while the total current budget for all HUD programs is $24.2 billion. By rough approximation, at least two-to-three million affordable housing units are currently needed in addition to those already available. The recent success of SCHDC strongly suggests that real estate counselors can greatly assist their housing agency clients by seeking out viable non-profits and applying many of the same principles systematically employed by SCHDC.

NON-PROFITS AND LOCAL GOVERNMENTS ARE NATURAL PARTNERS

For-profit real estate developers and investors are understandably motivated by the profit incentive. They tend to favor new construction over riskier rehabilitation projects and market rate rental housing versus low to moderate income rentals. Unfortunately, this frequently results in a misalignment of objectives with local governments. Local governments' primary incentives are preservation of existing housing stock and neighborhood revitalization, resulting in reduced costs for required public services (fire, police, etc.), and increased housing opportunities in the low to moderate income range.

Through non-profit/local government partnerships, local governments contribute debt or equity capital and the non-profit contributes management expertise and operating experience in the acquisition and development of affordable housing along with significant neighborhood revitalization benefits. The advantage of these revitalization projects are that they tend to be politically viable, avoid local resident resistance, maintain the existing housing stock, and accomplish these objectives at substantially lower costs. For example, a typical new construction affordable housing project in Southern California may cost $110,000 to $150,000 per unit while the typical revitalization project should fall in the $50,000-$75,000 per unit range. The typical partnership also provides for operating profits to be reinvested in the project rather than paid out as investment returns as in a typical for-profit project. Consequently, non-profit/local government partnerships provide an excellent vehicle for *creating* and *maintaining* affordable housing.

At present, most affordable housing programs have been fostered at either the federal or state level. However, it is local government which best understands the needs of local constituents and community development objectives. For this reason,

Public agencies frequently engage the services of real estate counselors to assess affordable housing needs, evaluate housing market conditions, analyze joint-venture proposals and financial projections, or make a variety of other recommendations regarding the potential success of the public/private venture. Prior project failures have caused understandable skepticism; few have truly flourished and succeeded.

despite existing federal, state, and local government cooperative programs, more affordable housing funds need to be shifted from federal and state programs, to the local level.

SOURCES FOR DEBT AND EQUITY CAPITAL

At present, there are several possible sources for required debt and equity capital which local governments may assist in procuring to finance the "typical" non-profit/local government affordable housing project. At Southern California Housing Development Corporation, each of the following sources has been employed at one time or another depending upon the unique circumstances of each individual project, the local political climate, and the community in which it is located:

1. ***Local Economic Development and Housing Set Aside Funds*** - these are Redevelopment Funds representing direct investment equity dollars;
2. ***Tax Exempt Bonds*** - provides first mortgage financing at 200 basis points or more below conventional mortgage rates for qualifying non-profit organizations;
3. ***Local Community Development Block Grants Funds (CDBG)*** - federal funds that can provide direct equity investment or pre-development expenditures;
4. ***Federal HOME funds*** - providing local government housing funds that for the most part are "without strings," but require compliance with Federal Davis-Bacon labor laws which could increase construction costs by 10 percent to 15 percent;
5. ***Federal Reserve Bank AHP Grants*** - direct equity investment funds restricted to low-income units only;
6. ***Low Income Housing Tax Credits (LIHTC)*** - provide private investor yields of 12 percent -16 percent and therefore encourages direct equity investments in non-profit affordable housing projects; and

7. ***Community Reinvestment Act (CRA) Loans*** - providing both conventional first and second mortgage loans underwritten with less stringent underwriting guidelines and offering more favorable mortgage rates.

Political will and commitment to neighborhood revitalization play an intregal role in which, if any, of the above resources will be available. In exchange for local political support and investment capital assistance, the non-profit housing provider assumes all responsibility for planning, development, construction, marketing, lease-up, and ongoing management. "Tight" operating and maintenance agreements protect the financial interests of the city while net operating cash flows are returned to the city and the property reserve fund accounts for on-going maintenance and capital improvements.

Equally important is a *mutual* commitment to mixed-income projects with a mix of market rate and affordable units, which more accurately reflect the true demographics of the neighborhood without the typical stigma of low-income housing. This generally requires that 40-60 percent of the units are available exclusively at market rental rates.

NEED FOR A STRONG AND EXPERIENCED NON-PROFIT

Through the years, most non-profit housing providers have completed only one or a few selected and usually small- to medium-sized projects. Frequently sponsored by local community groups, churches or other existing non-profit entities, most of these organizations have huge hearts, but lack the professional development and management experience required to successfully undertake one, much less several affordable housing projects. Hence, despite the non-profit status, a professionally strong organization is required to carry out each of the following requisites:

1. research and acquisitions;
2. construction and project development;
3. finance, accounting, and funds control;
4. property management;
5. general administration; and
6. resident assistance social programs

Not only must the organization be committed to "financially" sound projects, but must also be committed to improve the overall quality of life for its residents. The organizational objectives of a non-profit should go beyond safe, clean, and affordable housing. In the case of SCHDC, a separate 501C(3) Private Foundation, Hope through Housing, was established to deliver and fund social programs within its rental communities. By surveying residents at each of its locations, the foundation selectively provides child care, job training, after school tutoring, computer rooms, health fairs, senior activities, summer camps, and other programs tailored to the specific needs of each community and its residents. Hence, the non-profit partner must be an experienced and competent real estate company with the capacity and desire to provide a host of traditionally unrelated social services, ultimately resulting in greater tenant satisfaction, retention, and stabilized operating cash flows.

STRICT UNDERWRITING AND SELECTION ARE THE KEY

Since the typical non-profit/local government venture intends to hold the property into perpetuity, the underwriting guidelines necessary to insure long-term viability are strict. A problem property can not simply be disposed of, as the case would be with a for-profit entity. We suggest the following guidelines as a *minimum:*

1. A minimum project size of 100 units in order to insure cost effective operations and management;
2. 1.15 minimum debt service coverage ratio;
3. $2,800-$3,200/unit annual maintenance allowance;
4. meticulous accounting for adequate reserves for replacement;
5. all rehab design and construction to be completed with a 30-year life expectancy; and
6. adequate property management fees to ensure close supervision and strong tenant relations.

Affordable rental housing failures are generally caused by inadequate financing, poor construction, or poor management. The SCHDC underwriting philosophy is predicated on the desire to provide a quality mixed-income rental community that is financially strong, excellently managed, well maintained, secure, and responsive to tenant needs. This cannot be accomplished everywhere, in all cases. But it can be accomplished in most communities with a strong desire to clean up their deteriorating neighborhoods and revitalize older housing; the willingness to provide adequate funding; and the commitment to partner with only those who are objectively aligned with the needs of their community and the ability to do it right.REI

UNDERSTANDING THE TAX BASE CONSEQUENCES OF LOCAL ECONOMIC DEVELOPMENT PROGRAMS

by Richard K. Gsottschneider, CRE

It is generally accepted by economic development professionals and municipal officials that new real estate development will not only enhance the economic base of the community, but that it will also expand the tax base. The purpose of this article is to show that this is not always the case, and that new developments, if not properly planned, can in aggregate have a negative impact on the tax base. A recent case study prepared for Concord, New Hampshire, is used to illustrate some of the main points discussed herein.

Economic development traditionally focuses on such things as job generation, the provision of affordable housing, and the creation of retail centers. Tax base expansion focuses primarily on maintaining and enhancing real estate values within the municipality. In the author's professional experience, based upon working with cities and towns throughout the United States, municipalities tend to pursue economic development with almost a religious fervor, and often do not think strategically about the overall real estate impacts of their economic development initiatives. Yet, the existing tax base in almost every municipality throughout the United States is an important source of revenue for funding municipal and school expenditures.

For public sector officials it is important to recognize the potential for a conflict between these two distinct, yet overlapping areas of public policy, and to establish procedures to achieve the proper balance in this regard. For real estate investors it is important to recognize when public policy is not fully cognizant of the impact of its actions on the real estate market, because of the potential negative impact on property values. This article concludes with a series of recommendations for municipal officials to help them ensure that economic development projects in their community truly do enhance the local tax base.

ABOUT THE AUTHOR

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THE CONFLICT: HOW DOES IT OCCUR?

The conflict between economic development and tax base expansion can occur in one or more of the following ways:

New Development Detracts From an Existing Component of the Tax Base

Many forms of new development can detract from the existing tax base. Some examples include a new shopping center which has a negative impact on business and vacancy rates downtown; a new prison which creates a negative impact on an adjacent residential neighborhood; and a large subsidized housing project which adversely impacts market rate rental housing values. Naturally, not all new development within a community will have a negative impact, but these are three examples of the types of projects which can. Municipal officials need to be cognizant of the potential for negative impacts, and if they still decide to proceed with the development, to establish procedures for mitigating these impacts.

Zoning Does Not Properly Protect Existing Values

Zoning is the tool by which most municipalities establish and maintain certain land uses. Generally, zoning is relatively restrictive, except in certain cases where problems can occur. The two most frequent problems the author has encountered are in the typical office/industrial zone and at the edge of two incompatible zones. Within an office/industrial zone, property values can vary substantially. Suburban office buildings typically cost $90 to $110 per square foot, while light industrial and warehouse buildings cost around $30 per square foot. Also, parking, lighting, and landscaping requirements vary substantially. Why communities mix these uses in the same zone is not clear, but it is akin to allowing a mobile home park in the middle of an exclusive single-family residential community. The addition of an industrial building into an area of established office buildings will have a negative impact on the value of the office buildings.

The second type of conflict can occur when an industrial park is developed adjacent to a residential neighborhood without an adequate buffer, or a shopping center generates increased traffic through an existing residential or commercial area.

An Inordinate Emphasis is Placed on New Development

Many municipalities seem to forget about their existing tax base and infrastructure. Older neighborhoods, shopping centers, and industrial areas are allowed to "exist," but public policy and funding is directed to new development or possibly downtown revitalization. Yet even if these new developments are extremely successful, they seldom contribute more than one or two percent to the tax base. Meanwhile, the existing tax base in the rest of the municipality declines.

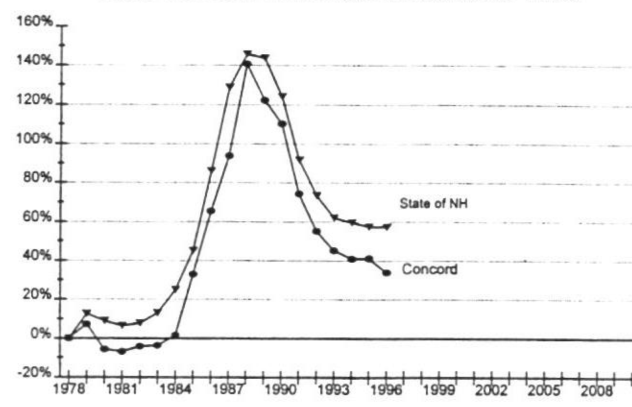
The purpose of these three examples is to illustrate some ways in which a municipality can pursue new development at one location and inadvertently cause property values to decline at another location. The following case study for Concord, New Hampshire, which was prepared by the author, illustrates these points more fully.

CASE STUDY: CONCORD, NH

Concord, the capital city of New Hampshire, has an estimated population of 39,000. The city is located in the central part of the state and has excellent regional highway access. The Merrimack River runs through Concord, but because of highway locations, the city is largely cut off from access to the river. Although total land area in Concord exceeds 41,000 acres, only a small portion of it is developed.

Concord is in the enviable position of having added over 2.8 million square feet of new commercial and industrial development in the last 12 years. The total assessment in the city, however, declined from $1.9 to $1.5 billion, or 19 percent, since 1990 *(Figure 1)*. Part of this decline is attributable to the recession at the beginning of the decade. Although real estate markets have recovered throughout much of New Hampshire since 1990, Concord's real estate values have languished. Today Concord has one of the highest tax rates in the state.

Figure 1:
City of Concord, NH
Real Growth in Assessment from 1978



Source: RKG Associates, Inc. and City of Concord Assessor

To help address the question of why, the city was divided into 10 sub-districts which were then evaluated for performance trends using the tax assessors data base (which fortunately was fully automated). Residential, retail, industrial, and office property trends, along with zoning and existing land uses, were then compared within each sub-district. The findings from this analysis were as follows:

- *New Retail Development Had Been a Mixed Blessing:* Retail values were relatively high in the major development corridors, but the assessment data indicates that older retail areas, in and around the downtown, were losing value as a result of additional competition. Alternate uses have not been found for these declining areas.
- *Commercial Encroachment Into Residential Neighborhoods Had Created Use and Value Conflicts:* Commercial and industrial encroachment into residential neighborhoods was having a negative impact on residential property values. Since residential property represented 57 percent of the municipal tax base, the overall impact on assessed values was sizeable.
- *Office Development Was Not Properly Segregated From Light Industrial/Warehouse Uses:* Current zoning allowed office and industrial property to be mixed in the same zones. The result was that developers were building low-end office space because of uncertainty over long-term values, so the city was not realizing the full value potential from office development within the community.
- *Office Development Was Not a High Priority Despite Its Tax Base Benefit:* Concord, being the state capital and having an excellent regional location, has strong office market potential. However the city had not developed a first class office park, despite the fact that in percentage terms office development utilized a relatively small land area which creates the highest tax base yield *(Figure 2).*
- *Residential Development Was Not Balanced:* Residential development over the years was not balanced between affordable, middle income and upper-end housing. For example, recent attempts to build an upper-end, empty nester golf course community were thwarted by environmentalists, while affordable rental housing projects proliferate and have adversely impacted the value of market rate rentals as well as for-sale properties.
- *No Adaptive Reuse Strategy Existed:* The city placed an excessive emphasis on preserving and reusing older buildings. The city had over one million square feet of vacancy in older buildings which are physically, functionally, and economically obsolete, and which in many cases occupied prime real estate. These vacant buildings had a negative affect on adjacent properties, yet the city had no real plan to work with developers to recycle or demolish these properties. Also, since these properties were zoned for office usage, and were empty, the city incorrectly assumed no office market existed.

The net result of this analysis showed that while substantial new growth had occurred in Concord, it had often been to the detriment of existing property values. The city also lacked a long-term strategic focus for managing its tax base and did not fully understand the linkage between tax base management and economic development.

RECOMMENDATIONS FOR BALANCING ECONOMIC DEVELOPMENT AND TAX BASE EXPANSION

The experience of Concord, New Hampshire, is typical of other municipalities across the United States. Well-intentioned efforts to bolster local economies often have unintended negative consequences on some portion of the tax base. Also, state and federal policies and actions, such as the location of a new highway, can have both positive and negative impacts on local real estate markets. Within this context, as well as local politics, the economic development professional must function.

The following recommendations are offered to municipalities seeking to not only pursue economic development but also to maximize the tax base benefit from these initiatives.

- *Monitor Land Uses and Tax Base Contributions-* From a strategic perspective it is important to understand not only how land is being utilized within a community, but also the respective contribution of different types of land uses to the tax base. For example, in Concord residential properties represented 57 percent of the assessment in the city, and residential values were declining faster than the city could add new commercial and industrial tax base. It became readily apparent that a neighborhood revitalization strategy was almost more important than building another industrial park.
- *Evaluate Impacts of New Projects* - Politicians

Figure 2

City of Concord, NH Analysis of Land Utilization & Contribution to Real Estate Assessment		
Land Uses	**% of Acres**	**% of Assessment**
Residential	32%	57%
Industrial	2%	6%
Retail	1%	13%
Office	2%	11%
Other Improved Property	7%	10%
Unimproved Property	56%	3%
TOTAL	100%	100%

Source: *RKG Associates, Inc. and City of Concord Assessor*

and economic development professionals often assume that a new project, such as a shopping center, is good for the community at large as well as the tax base. While this may be true, it may also be true that the market cannot support a new center without having an adverse impact on either the downtown or existing older centers. As a result the community may gain tax base in one location, only to see values decline in another.

- *Monitor Real Estate Markets* - It is important for economic development professionals to monitor all real estate markets in their community, and to initiate actions to maintain the viability of these markets.

- *Do Not Compete With the Private Sector* - Many municipalities develop industrial parks and sell the land at or below cost to attract new employment. This concept often makes sense in areas of dire economic need, but does not make sense in a healthy economy and vibrant real estate market. In the case of Concord, NH, the public sector was marketing office/industrial land for around $25,000 per acre when the private sector was trying to sell similar land at up to $50,000 per acre. Yes, the lower priced land helped attract some tenants, but it also reduced the real estate value of the private sector's property.

- *Separate Office and Industrial Uses Where Possible* - Office and light industrial uses are typically included in the same zone in most municipalities, however office buildings often cost three times more than industrial buildings to build. This type of value disparity among uses does not benefit the tax base anymore than mixing subsidized housing and single-family homes in the same neighborhood. Also office parks require a more comprehensive set of design standards and guidelines to remain viable, similar to an upscale residential community.

- *Utilize Incentives* - Traditionally municipalities utilize incentives to attract businesses to create jobs, and it works. Why not use incentives to enhance the real estate asset, such as a zoning density bonus for good design? Commercial and industrial tax abatements are not recommended because they can mushroom out of control, and ultimately can place too much of a burden on residential property.

- *Include the Tax Assessor in the Economic Development Process* - In most municipalities, the economic development function is managed by an economic development department (or authority) and there is usually a strong working relationship with the Department of Public Works. The tax assessor is seldom consulted, but in the author's opinion, should be an integral part of the team.

- *Establish Design Standards* - Design standards can help a community derive the maximum tax base benefit from a project. Little things, like a brick facade on an industrial building, rather than cinder block or corrugated steel, can make an important difference in the value of the building and in the overall image this project represents to the entire community.

- *Buffer Potentially Incompatible Uses* - Many communities experience conflicts between industrial and residential zones or commercial and residential areas. These conflicts may arise from traffic, noise, or simply a gradual encroachment as properties are converted (via a variance) from one use to the other. For example, in Concord single-family residential properties adjacent to the downtown have been converting to multi-family or office usage. The land use and parking requirements of these various uses are different, which can cause conflicts and an ultimate loss in property values. Where possible clear buffers and boundaries should be established.

In summary, the concept of tax base management is really one of asset management and is particularly important in states where municipalities derive much of their revenue from their real estate assessments. To underscore this point, it was demonstrated to city officials in Concord that a five percent overall increase in the assessed value of existing property would have the same impact on the tax rate as the addition of two million square feet of new industrial property or one million square feet of new office/R&D development, both of which are likely to take 15 or more years to realize.

In addition to being responsible for managing the tax base, a community should also be responsible for helping to ensure economic prosperity for its citizens. These two goals can be in conflict unless a long-term view is taken regarding public policy actions, and if the impacts of alternate development actions and programs and priorities are not carefully evaluated. In the author's experience, good tax base management will lead to even better economic development because investors and businesses will want to be in your community. Instead of offering incentives to attract business, they will be willing to pay to come to your community because it is a good place to live, work, shop, and play.REI

FORGING A NEW PARTNERSHIP: THE REAL ESTATE PROFESSIONAL AND THE NOT-FOR-PROFIT WORLD

by Richard S. Stanson, CRE, & Myra R. Karse

Real estate needs to change and grow to remain competitive in today's fluid economy. As professionals, we must remain open to change in order to grow with the times. We need to face the realities of fiscal conservatism, corporate downsizing, and demands for increased levels of services. These realities are issues to be dealt with by everyone in the business world, and the not-for-profit sector is facing those same realities. Not-for-profit organizations, ranging in size from small neighborhood churches to immense foundations, virtually all operate under Internal Revenue Service Section 501 C(3) or related tax exempt sections of the Code. At the end of 1993 there were more than a million such entities in existence, with more coming on line in each ensuing year. Fund- raising from a variety of sources is the lifeblood of the majority of these charitable endeavors. Using real estate as a funding medium has been, by and large, overlooked, misunderstood, and feared by most charities. Real estate professionals have added to the problem by mystifying what they do, how they do it, and how they charge for their services.

There are many charities across this country with widely varying missions, but they all have one thing in common: each would welcome expanded income but is finding it increasingly difficult to garner a larger share of the public's dollars. Of course, it is easier for many charities with broad appeal like the American Red Cross or single disease groups such as the American Cancer Society, because of their size and wide-spread visibility. However, even when a charity is less well known, there are ways to augment its cash flow. One method is to foster real estate gifts as an additional revenue stream.

For many charities, real estate has traditionally been a bugaboo. Occasionally a property may come in via a bequest, taking a charity by

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surprise. A quick decision to accept or decline usually must be made. More frequently than not, the property is declined because the organization feels it is safer not to accept it. A charity may be afraid of making a mistake that might have an adverse effect on its image and the work it does. Often, real estate gifts are misunderstood, do not represent immediate cash flow, and require expertise that is not immediately available. Also, a charity may have held real estate in portfolio for so long - with no attention having been paid to it or without any efforts having been made to dispose of it - that it thinks it cannot benefit from further real estate. In either case, the perception is that property does not work for their organization.

FACTORS INFLUENCING REAL ESTATE SUCCESS IN CHARITIES

The Executive Director - to build an organizational commitment to the value of real estate to an organization, the executive director and the staff members need to be in an acceptance mode. It is important that the organization speak with one voice when dealing with potential donors. The entire staff needs knowledge and awareness of real estate's value to the organization to answer basic donor questions. All too often, fund-raisers tend to have a parochial view of the world. They are deeply committed to raising money and sometimes may become locked into a particular pattern of fund-raising, perhaps special events or direct campaigns. They need to be convinced of the value of expanding their fiscal horizons.

The Board of Directors or Trustees - boards of directors also need to understand and support the commitment to real estate as a function of fund-raising. The board needs to understand the importance of having a system in place that can act quickly on real estate transactions. Since most boards of charities meet on a quarterly basis (or even less frequently), an Oversight Committee should be appointed to act on behalf of the board. The board should also pass a stock motion with liberal authority attached to it as well as resolutions authorizing the Oversight Committee to act.

A Coherent Gift Acceptance Policy - of prime importance is an organizational gift acceptance policy. The board, the executive director, the charity's planned giving officer (if appropriate) and outside consultant(s) should determine what types of properties *are* or *are not* acceptable. They should also determine procedures to follow during the acceptance process. Examples of non-acceptable properties include heavily mortgaged real estate, remote land, or environmentally impaired parcels. This policy, as well as policies and procedures addressing managing/operating real property if necessary, should be ratified by the board and in place before serious consideration of a real estate program for the charity. Certain facts must be confirmed: the environmental status of the property is not adverse to the charity; the title to the property is clear and without blemish; and the physical condition of the property is as advertised when the donor presented the donation possibility.

The Finance Department - within most charities it is the finance departments (skilled as they are in managing difficult cash flow and phantom financial sources), who are often unaware of the potential value of real estate to their organization. Yet it is most often the finance department that keeps the important real estate records and documents, and that is receiver of income and expenses for property held by the charity. An educational training program for finance department employees can enable them to flag real estate activities and costs in order to monitor properties held to determine which might need to be reviewed to keep the portfolio producing income.

PROGRAM MANAGEMENT: VOLUNTEER OR PROFESSIONAL?

In many charities it is a common practice to use volunteers. The work done by volunteers would be unaffordable to most charities if they had to pay for it. Volunteer help is universally accepted as the least expensive way of administering many programs and activities. Volunteers used in a real estate program would likely be board members or volunteers who are real estate brokers. They may be called on to handle the sale of donated property at reduced or no commissions. The real estate may or may not be in the volunteer's area of expertise or locale. However, as time passes without the property selling or leasing, the level of interest by the volunteer could tend to wane. Understandably, the volunteer's paying clients would receive primary attention.

Sometimes volunteer assistance can backfire on an organization, as in "The Case of the Inattention of a Normally Attentive Person." In the early 1970s, a widowed donor bequeathed her home in an upscale area of a city to a charity along with a life estate interest for the woman's minister and his wife. In 1992, when the last user of the property died, it became a donated asset. Although the house was quite old and not in good condition, the land was very valuable for a new structure. An appraisal for nearly $3,000,000 was obtained and the house was placed on the market for that amount with a local real estate broker. The client's Asset Management Committee placed the burden of managing the transaction on its chair, a skilled industrial executive. Within a month, a cash offer for $2,450,000, with a quick closing, was received. For some unknown reason, the chair sat on the offer. Perhaps he hoped the buyer would make a higher offer, or was just plain too busy. Whatever the reason, he waited to make a counter offer. Then, after four weeks of delay by the client/seller, the offer was withdrawn and the $2,450,000 disappeared. The residential real estate market then went into a slump due to an economic downturn. Six months later, a consultant was brought in, interviewed real estate brokers, got a multitude of comparable sales figures, and eventually was able to sell the property for $1,700,000. This is an example of what can happen when volunteers are unreliable at a critical time in a transaction.

THE ROLE OF THE PROFESSIONAL ADVISOR

The first question for an organization to consider when seeking help is which type of professional would be best suited to help the not-for-profit meet its fund-raising needs in a practical and cost-effective manner. There are several possibilities available and each offers specific functions. As real estate generalists with comprehensive real estate backgrounds, Counselors make impeccable advisors to not-for-profit organizations. Most have spent time in brokerage, property management, mortgage banking, and/or appraisal.

The advisor to a not-for-profit should be broadly experienced in order to handle all types of problems with enough knowledge to complete an assignment expeditiously and economically. Members of a professional organization, such as The Counselors of Real Estate, would practice with strict adherence to a code of ethics, including prohibition against actual or perceived conflicts of interest. A real estate consultant, then, should be willing to work for a charity on a fixed-fee basis, either hourly or by the job. Although contingent fee arrangements are not prohibited, a greater degree of caution regarding conflicts of interest is called for. In any event, the Counselor would always place the interests of the client first and foremost in any advice provided, regardless of the method of compensation.

The first question for an organization to consider when seeking help is which type of professional would be best suited to help the not-for-profit meet its fund-raising needs in a practical and cost-effective manner. There are several possibilities available and each offers specific functions. As real estate generalists with comprehensive real estate backgrounds, Counselors of Real Estate (CREs) make impeccable advisors to not-for-profit organizations.

A real estate broker can and should be used for the marketing and completion of a project, especially if the work to be done is a straightforward disposition of a parcel of real estate. The advantage of using this professional is that he/she could come from a variety of specialties such as residential sales; commercial and industrial sales and leasing; farm land brokerage; or retail leasing. Of particular importance is that the broker has local knowledge. The charity would have the option of choosing between a number of individuals with the proper credentials, allowing the organization to use the best source for a sale or a lease. The duration of employment of the commissioned broker is as long as the listing length on the particular property. If either the charity itself or the broker was not happy with the progress being made, at the expiration of the listing the charity could choose not to extend the listing contract or the broker could withdraw.

One great advantage of an arrangement with a commissioned real estate broker is flexibility for the charity. Another is that payment does not have to be made until the transaction is complete. In the case of a charity acquiring real estate for its own use, the commission would be paid by the lessor or seller, therefore the organization would have no out-of-pocket expense.

The real estate appraiser is the real estate professional that a charity might want or need to use regularly. It is always necessary that the donor obtain an appraisal report by a designated member in good standing of one of the appraisal institutes in the U.S. In fact, this is a requirement of the Internal

Revenue Service in order for the donor to be able to deduct the gift from his federal income taxes. The donor must provide an appraisal that has been done within 90 days of the date of the gift. There is a requirement that the charity file an IRS Form 8282 within the first two years of the acceptance of a real property donation if the property sells for less than the donated value.

Often, the donor has no idea whom to hire as an appraiser of the property to be donated. Most attorneys, accountants, or trust bankers have a list of qualified appraisers, but the recipient organization may have to provide names to the donor. Real estate appraisers are as widely specialized as brokers and must be chosen with care and a view to the type of property and use of the appraisal.

TAKING CARE OF DONORS/CLIENTS

Even if the nature of one's practice is to serve charities, one is likely to encounter individual donors. If that donor desires to give real estate, some precautions are in order. First, as previously stated, for any property worth over $5,000, a recognized and certified appraiser must complete an appraisal. If the charity is one the donor has been closely involved with, he/she can speak to the charity directly. If not, this is an area where the professional can make a difference in negotiations between charity and donor, having the facts ready, preparing the property for the gift, and helping to determine the timing of the gift.

Having some control over the appraisal is very important. If the charity takes in a property valued in excess of $5,000, it has two years to sell the real estate at the appraisal or higher. If it is sold for less than the appraisal within that two years, the charity must file an IRS 8282 form, and the donor stands a chance of his/her tax return for the year the property was donated becoming open for review. This is especially dangerous if the selling price is more than 10 percent lower than the appraisal. The issue here is that the charity does not want to either inconvenience or anger a donor because that funding source might be willing to give again. However, the charity can only receive property as an unconditional gift and has the right to do with the property as it sees fit. In this fact lies the dichotomy. The way to relieve the donor is to negotiate with the charity of the donor's choice, or find a charity that will accept his property.

SECONDARY DIRECTIONS FOR EXPANSION

Any not-for-profit attempting to expand its real estate presence will need a consultant who can offer a training and education presence, as well as the aforementioned skills. Financial departments and fund-raising staff will need training that will allow them to be comfortable with overseeing property portfolios; executive directors will need coaching so they can direct their boards and boards of directors will also need enlightenment, and some tutelage, in order to make wise decisions. This creates a new niche, one that will assist in reshaping real estate's role in the marketplace.

Being prepared to assist any not-for-profit is a service that a real estate professional should not give away for free. Doing so will not offer the charities in a Counselor's community the long-term solution for accepting real estate. The service that the charities need is a professional real estate advisor who can offer counsel just as an accountant or lawyer would, with payment for services rendered. REI

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ABOUT THE AUTHORS

(Myra Karse, continued from page 23)

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Privatizing Today's Public Housing

by Philip A. Hickman, CRE

This manuscript provides an overview of some of the major structural changes occurring in the public housing business as illustrated by the HOPE VI Program and utilizes the redevelopment of the Henry Horner Homes in Chicago as a case study.

NATIONAL OVERVIEW

Although Public Housing Authorities (PHA) are local in nature, they are a creature of Congress' authorizing legislation — the Housing Act of 1937. Currently 3,400 public housing authorities own and manage about 1.2 million housing units and administer over 1.2 million Section 8 certificates and vouchers for rental of privately owned apartments by low income households.

PHAs are typically governed by a Board of Commissioners appointed by the mayor or chief executive officer of the governing jurisdiction, whether it be a village, city, or county. Some PHAs have fewer than 250 units while others have several thousand. The largest PHA is New York City with over 140,000 units. The U.S. Department of Housing and Urban Development (HUD) has oversight responsibility for housing authorities and it provides the capital funds for the development of new public housing; capital funds for modernization; and an operating subsidy since, in most all cases, the monthly rental income is insufficient to pay the operating expenses. In Fiscal Year (FY) 1998, Congress provides PHAs $2.5 billion for capital grants and $2.9 billion for operating subsidies. The national budget for the Section 8 (vouchers and project-based) program is $9.3 billion.

The quality and effectiveness of PHA's property management varies widely from city to city. HUD's system of evaluating a housing authority's management each year is referred to as the Public Housing

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Management Assessment Program (PHMAP). PHAs that receive a PHMAP Score over 90 points are considered "high performers" and those receiving under 60 points are considered "troubled." The most recent PHMAP Scores for 1996 ranked 83 PHAs below the threshold score of 60. These "troubled" PHAs range in size and location. The largest are Puerto Rico with over 57,000 units and the Chicago Housing Authority (CHA) with over 40,000 units. The small city category with "troubled" scores includes Washington, DC, and Ann Arbor, Michigan. Just as size and locations vary, there are usually multiple reasons for the poor condition of the housing. The common denominator is that the housing authority communities suffer from functional and/or economic obsolescence.

The 83 PHAs on the troubled list represent less than three percent of the total number of housing authorities but represent about 10 percent of the total PHA housing stock.

The typical PHA provides much needed affordable housing for families and for seniors in their community. The image of public housing is influenced by some of the large city "housing projects" of dubious notoriety. For example, a few years ago at a conference in Florida attended by housing officials throughout the country, a housing authority director from Virginia indicated their city's cable company telecasts Chicago's WGN-TV programming and the image of public housing in his city was strongly influenced by the images of shootings, gang activity, and frequent social problems reported by WGN at the CHA's Cabrini-Green in Chicago. Even though his PHA had no high-rise public housing, and no major problems, he reported the public perception of public housing in his city was that his properties experienced problems similar to those that WGN reported at Cabrini-Green.

This image vs. reality scenario often influences national policy toward public housing. Jack Kemp, the HUD Secretary under President Bush, did not want to deal with the high level of distress at the worst properties by demolishing them and stated publicly that, "he did not want to be known as the Secretary of Demolition." As a result of this policy, many functionally and economically obsolete buildings were allowed to stand.

With the changes of administration in 1992, President Clinton's first Secretary of HUD was Henry Cisneros, the former Mayor of San Antonio. Secretary Cisneros' attitude towards these distressed properties was more aggressive in favor of demolition. He was instrumental in establishing and strongly supporting the current demolition policy. Under his administration, the goal was to demolish 100,000 of the worst public housing units. A program, titled Hope IV, was created to deal with the largest and worst public housing properties. The program involves the private sector in an effort to bring accountability to the public housing program.

THE HOPE VI PROGRAM FORCES STRUCTURAL CHANGES TO THE SYSTEM

The fundamental goals of the Hope VI public housing transformation *(as quoted from the program guidelines)* are to:

1. Change the physical shape of public housing, including substantial rehabilitation and/or demolishing severely distressed housing. To replace it with units that blend with the surrounding neighborhoods and are attractive and marketable.
2. Achieve resident self-sufficiency and provide comprehensive services that enable residents to move into employment and self-sufficiency.
3. Achieve quality management and improve the quality of life for residents by ending the social and economic isolation of public housing residents.
4. Promote home ownership and as broad an income mix as possible.
5. Promote partnering with local agencies, governments, non-profits, and private businesses to leverage resources, jobs, and attract businesses to the community.

The FY 1998 funding for the Hope VI Program is $550 million and since its creation in 1993, over $ 2.5 billion has been allocated to the Hope VI Program. The FY 1999 Hope VI budget is expected to be $600 million.

Hope VI funding has been awarded to cities with massive distressed housing including: Newark, New Jersey, and Chicago, and to smaller cities such as New Orleans and Chester, Pennsylvania. Many cities have been slow to complete the necessary planning and begin to utilize the funds. In cases where agencies lack development capacity, HUD has required the use of "program managers and/or a private developer" to assist the PHAs with the planning and implementation of the revitalization plans in their respective communities. The PHA funds are directed to a private developer (in some cases these are community based non-profits) who own and manage the property under a new development method referred to as "mixed finance." Usually the program manager and/or developer is made up of a team of people including architects, engineers, planners, tax credit syndicators, lenders, developers, property managers/appraisers and, yes, even Counselors of Real Estate (CREs).

BUILDING SUSTAINABLE COMMUNITIES

Building a "sustainable community" is the key to revitalizing public housing. This involves the construction of quality housing and building resident capacity for long-term self-sufficiency. The living unit, by necessity, needs to be of good quality; however people just don't buy or rent a house, they also buy a community, which is a collection of services and amenities. Key components of any viable community are public services such as schools, parks, libraries, day care centers, and public safety. The Hope VI Program recognizes that building community must involve the local municipality and other local institutions. For example, in one city, the local junior college has coordinated with the PHA to provide computers, computer training, and a network system for their residents. All of this recognizes that the ultimate goal is to enhance residents' lives and create family self-sufficiency. A concerted effort is necessary to improve residents' basic education and job training skills. Simultaneously, it is necessary to end the isolation and concentration of very low income people.

MIXED INCOME COMMUNITIES

Private Development and Management

The basic premise of the new HUD program is that a mixed income residency is necessary and basic to the long-term viability and sustainability of communities. If nothing else, over the last 50 years, we have learned that the concentration and isolation of large numbers of very low income families, in high density, high-rise buildings, does not provide the environment or opportunity for families to build self-sufficiency.

Private companies have been involved in the development and management of low and moderate income housing longer than housing authorities. Congress and HUD recognize the experience and abilities of the private sector and are utilizing them to bring about greater professionalism and accountability to the public housing program. For example, PHAs in Indianapolis, Houston, and Philadelphia are privatizing ownership of units. PHAs in Miami, Puerto Rico, and Chicago have hired private property management firms to manage some or all of their properties. Chicago currently has over 16,000 units under private management. These properties include both family and senior housing.

Building a "sustainable community" is the key to revitalizing public housing. This involves the construction of quality housing and the building resident capacity for long-term self-sufficiency. The living unit, by necessity, needs to be of good quality; however people just don't buy or rent a house, they also buy a community, which is a collection of services and amenities. Key components of any viable community are public services such as schools, parks, libraries, day care centers, and public safety.

THE CHICAGO CASE STUDY

Building a New Community

In addition to the private opportunities for development and management of public housing, in certain situations, federal courts have appointed receivers to operate or manage some or all of the agency functions. Two recent examples are in Kansas City and Chicago. In Kansas City a private company is the court-appointed receiver to operate and administer all the business affairs of the PHA. In Chicago, the federal court has appointed a receiver for the CHA's development of all non-elderly public housing. Private development firms have also been hired by PHAs to develop housing using public housing funds in cities such as Detroit, Boston, San Francisco, and Atlanta.

Daniel Levin and The Habitat Company were appointed as receiver for the Chicago Housing Authority's non-elderly development programs in 1987. Since that time the firm has developed or has under construction over 2,300 housing units located in 47 different community areas of the City of Chicago. This development includes both traditional "scattered site" units, with an average density of less than four units per site, *and* the major redevelopment of large properties such as Henry Horner Homes, which originally contained 1776 apartments. The redevelopment and construction of replacement units at Henry Horner Homes is the topic of the following case study.

Henry Horner Homes is planned to be redeveloped in five phases. The first phase involves the demolition of 466 units in five elevator buildings, located on two super blocks, totaling approximately 10 acres. Phase two involves the demolition of two, 16-story high-rise buildings with a total of 285 units on approximately six acres. Approximately 75 new town homes and a park will be constructed back on the original site of these high rises. *(Photo 1)*

Photo 1

A high rise before relocation and demolition

The "Before" Conditions

The family elevator high-rise and mid-rise buildings at Henry Horner were the subject of Alex Kolovitz's book, *There Are No Children Here.* (Oprah Winfrey starred in the movie of the same title). The Chicago Housing Authority is reported to have some of the worst housing stock in the country, and Henry Horner Homes was some of the worst of the worst.

Public disinvestment at Henry Horner, along with gang activity, and active drug dealing, led many residents to "vote with their feet" by abandoning their apartments and leaving the area. These same conditions led to private disinvestment in the adjacent neighborhood, and the abandonment of private property. The result — derelict buildings and vacant lots with abandoned cars, and extensive fly dumping of debris — fed a downward cycle of conditions fitting the label of intercity neglect.

The "After" - Community Building Process

Henry Horner has the advantage of close proximity to downtown Chicago and the United Center. The demolition of the Chicago Stadium and the construction of the United Center, (home of the Chicago Bulls and the Blackhawks), was the first substantial private investment in the neighborhood in over 50 years. Ownership of the United Center in cooperation with Near West Development Corporation, a strong local neighborhood group, and the active support of the City administration all combined to rebuild a new community on the near west side of Chicago. The redevelopment also involved close coordination with the Horner Resident Committee, (and their consultants), and local non-profit alliances with contractors which were required in a Consent Decree approved by the Federal Court.

MIXED INCOME TENANCY/PRIVATE MANAGEMENT

The Horner Consent Decree requires CHA to hire a private property manager for both the existing property and the new replacement housing.

In addition, the court mandated the new housing be rented to families with mixed incomes — 50 percent must have incomes from 50 percent to 80 percent of area median incomes (working families) and 50 percent with incomes under 50 percent of the area median income (AMI).

In this case, a working family of four has an annual income in the range of $25,000 to $42,000. The typical very low income CHA family has an income about 10 percent of AMI. *(Photo 2)*

THE PHYSICAL PLAN

The Habitat Company planned the redevelopment of Henry Horner Homes, utilizing the same basic principles of a high quality residential community: good site planning, defensible space, low life cycle costs, attractive design, quality construction, and amenities to attract and hold quality residents.

In addition to the construction of 200 new townhouse units back on the former high rise site, the plan provides for construction of 266 additional units

Photo 2

Superblock under construction (200 new town homes)

within an eight-block radius of the super block site. It was necessary to acquire 130 vacant lots within the immediate neighborhood for the replacement housing. These lots were acquired on the open market and from the City of Chicago. The total development budget for Phase I is $55 million or approximately $118,000 per unit for a three + bedroom unit. Phase II is funded with $18 million.

As in the development of any new community, a new name was selected for the area, in a collaborative effort lead by the neighborhood group, but also involving the resident committee, CHA, and Habitat. As a result, "Westhaven" was selected as the name for the broader community. Hence Henry Horner Homes is no longer used to describe the former public housing area.

Site Planning

The site plan provides for the restoration of the street grid typical of the adjacent neighborhoods. It is popular to call this part of the "New Urbanism" but this design is as old as Chicago. The City of Chicago was very supportive of this program and provided over two million dollars in funds for new infrastructure such as new streets, alleys, curbs and gutters, water and sewer lines, and street lights. The strong financial support of the City of Chicago for the new infrastructure enabled maximum dollars to be used for the new housing.

The design quality and amenity level of the replacement housing at Henry Horner are significantly higher than what has typically been developed as public housing. We believe this quality was necessary to attract working families to an area that previously suffered from extensive crime and derelict buildings.

To supplement our own development experience, we received input from working families living on the West Side of Chicago in two focus groups conducted by a professional marketing firm. Concern for security and defensible space was of prime importance to everyone in these focus groups. Keeping in mind our objective was to develop a sustainable, mixed-income community, we focused on the following program characteristics and amenities. *(Photos 3 & 4)*

Site Plan and Program

1. Restores the street grid and weaves the new homes into the adjacent neighborhood;
2. Provides individual parking spaces adjacent to each townhouse (no large parking lots);

Photo 3

New two-story town houses on Superblock. Note the attached garages.

Photo 4

New town houses on Superblock. Note the two-story town house over flat.

3. Provides attached garages for 40 percent of the units on the Superblock;
4. Provides private play areas for each family and a small park with homes situated to provide "eyes on the park";
5. Provides low density with each unit facing the street, including a mix of unit sizes from one to six bedrooms;
6. Provides for 50 percent working families;
7. Provides for private property management.

Building Features and Amenities

1. A private entry for each town home;
2. Individual gas furnaces with central air conditioning;
3. Wall-to-wall carpet (typically public housing has vinyl tile);
4. In unit washer/dryer hook-ups;
5. All brick exteriors, front porches, bay windows, and hip roofs with "curb appeal";
6. 1 ˚ baths in three-bedroom town home units, and 2 or 2 ˚ baths in larger units.

The market response to the product has been overwhelmingly positive. The working family units on the former Superblock were occupied quickly and there is a waiting list of over 300 families. Rents are pegged at 30 percent of income with a ceiling of $650.00, plus utilities, for a three-bedroom town home. The housing and the new community are considered a good value and allow the private manager to be very selective from the families on the waiting list.

COMMUNITY BUILDING

Just as the bricks and mortar must be developed in a manner sensitive to the context of the community in which it is constructed, it is necessary to provide for much more than just the building itself.

As indicated, the City of Chicago has shown a strong commitment to the neighborhood with the construction of new community infrastructure. In recent years the City has constructed a new library; enhanced a firehouse; targeted housing rehab and redevelopment programs in the area; provided substantial resources to the three schools in the immediate area; and rehabilitated a park.

In addition, the Bulls Charitable Foundation has supported youth in the area with the construction of a four million dollar James Jordan Boys and Girls Club.

CONCLUSION

The redevelopment of public housing communities around the country is taking place utilizing the Hope VI Program and other HUD funding sources. These redevelopment efforts need the talents and time of the professional real estate community. This is an ideal opportunity for CREs to be involved in rebuilding communities and helping to reestablish quality affordable housing as a part of the fabric of their respective communities. REI

CREs & Non-Profits:

Counseling Denominational & Educational Entities in Today's Changing Real Estate Environment

by Frank J. Parker, CRE, & Alanna McKiernan

ABOUT THE AUTHORS

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Non-Profits in American Life

Drawing from its historical English constitutional roots, the United States has always pursued a public policy of favoring non-profit organizations in order to serve the public good. The Internal Revenue Code in Chapter 501-C(3) provides Federal tax exemption to a large number of such organizations considered to be adhering to "eleemosynary purposes." Traditionally, in its broadest sense, the word eleemosynary has been defined to include organizations engaging in activities devoted to the general spiritual, cultural, and charitable betterment of the population as a whole.

Throughout the spectrum of traditional mainstream churches in the U.S., there has been a notable decline in attendance in the past few years. Inevitably, revenues have plummeted also. At some point, the need for them to address real property questions becomes paramount. Many times their property has been long held and is extremely valuable. Without proper real estate counseling advice, wrong decisions risk being made at a time when the struggling church group desperately needs every cent it can obtain in order to carry on its mission and goals.

In the past, denominational religious groups of all persuasions reached out far and wide to provide for the schools, colleges, and hospitals which served so many. Gradually these services have been assumed by governmental entities and for-profit service provider competitors. Ever since the start of the G.I. Bill after W.W.II, there has been a major shift toward public funded higher education. Recently, this trend has adversely impacted some private colleges and universities. As tuitions rose, enrollment at some such colleges and universities has slipped, especially at institutions not of the highest quality. A similar situation of deterioration has occurred in the past few years with a number of non-profit hospitals that have been caught in the backlash of the health care revolution.

NON-PROFITS AND THEIR REAL ESTATE

The key tactic for assisting these groups is to recycle disposable realty either by sale, adaptive re-use, or creative joint venture entrepreneurial projects. However, carrying out this suggestion is often not as easy as it may seem. It is imperative that the non-profit organization in question and its advisors are able to conceptualize the various complications that may arise during any real estate transaction, especially those to which non-profit organizations are particularly susceptible to encounter.

With regard to denominational institutions, problems of ownership almost inevitably occur when joint-ventures under any guise are undertaken with profit making companies. Who within the church has the authority to sign as owner of the property? Similarly, who makes decisions for the church? The lack of a chief decision maker or the need to defer to the opinions of people within or without the organization, and who lack knowledge of real estate, can make it difficult to do business with such non-profit organizations.

To illustrate the point, recently, an ugly public dispute on property ownership took place between the University of St. Louis, its Trustees, and president on one side and the Roman Catholic Archdiocese of St. Louis and the Vatican on the other side.

The medical school of the University of St. Louis was losing enormous amounts of money. In order to continue it as a viable entity, the decision was made to sell the hospital attached to it. The buyer was to be Tenet Health Care Corporation, the second largest health system in the Untied States. The Archdiocese and the Vatican said that this hospital could not be sold without their permission because everything at the University of St. Louis was connected directly to the Catholic Church. The University of St. Louis replied that when the Board of Trustees of the University took on non-clerical members in 1967 and incorporated separately, (thus separating the university from its Jesuit Community), the University became a totally lay organization. By this reasoning, there was no need to ask the permission of the Vatican or of the Archdioceses before the hospital was sold.

Eventually, an uneasy compromise was forged. However, from now on, anyone giving advice to Catholic institutions should keep the ramifications of this decision foremost in their minds. No one wishes the local Catholic Diocese or the Vatican to sue to stop a sale.

DISPOSAL OF SURPLUS REAL ESTATE

A number of non-profit institutions, if they were accurate in self-appraisal, would admit that some of their greatest mistakes have occurred in connection with the disposal of real estate. An old truism in real estate as valid as the location truism is that, "They are not making any more real estate." Its corollary is that, "Once the property is gone, it is gone." Both sides of this coin apply to a number of misguided sale decisions by denominational and educational entities made under short-term pressures that, in retrospect, have led to error and regret.

The reasons for miscalculations in buy or sell decisions are numerous. Often, it is an immediate panic move. Attendance is down. Cash flow is perilous and endowment fund returns are disappointing. What to do?. . . Sell real estate?. . . What else?. . . Sometimes it appears that no other answer exists; but often one does. Among other possibilities are sales and leasebacks, joint-ventures, and ground leases. All three strategies are frequently employed alternatives to outright property disposition, straight forward property leases, or the trio of alternative deployment options just mentioned.

The sale-leaseback alternative, as its name indicates, describes a legal transaction in which the property in question is sold to a buyer normally interested in it for value appreciation purposes. Then, this piece of land is leased back to the seller, (in this case the educational institution), normally because it desires to retain classroom space. A variant of this transaction would be a joint-venture in which the partners, (normally a corporation and the denominational or educational institution with which it is involved), would divide ownership of the lands and buildings in question as agreed upon.

A ground lease is another option. It occurs in two different situations. Either there is a lease of undeveloped land on which a ground tenant will construct improvements or, in the alternative, there is a lease of improved real estate that covers the land alone and not the improvements upon it. In either case, the term involved usually extends from 25 years to 99 years.

For any denominational or educational non-profit that is looking ahead, before resorting to fire sales or the bailout variants discussed above, it is recommended to view the land involved in terms of its capacity to be adaptable for scientific and telecommunications technology. One should also not forget to investigate residential subdivision opportunities. In addition, educational institutions may be able to take advantage of their tax exempt status to prepare land they own for eventual sale to commercial buyers unable to obtain the necessary regulatory approvals for the desired usage. Strategic value enhancement of this nature could substantially increase the price of an eventual commercial sale. Also, denominational and educational organizations should not forget to explore the possibility of golf course or automobile garage construction on the property in question. Currently, both are red hot items in today's pleasure-driven environment.

Non-profit organizations are always concerned that whenever they sell their property or enter into a joint-venture concerning it, the Internal Revenue Service will tax the proceeds. They should not be unduly concerned. A recent IRS ruling indicates that institutions of higher education will not be charged with "unrelated business taxable income" (UBTI) from the sale of a property held in trust. Therefore, the property in question will not be considered as debt-financed property during the time it is owned by the educational entity. Answering a hypothetical question, the IRS stated that when a college was both the trustee and the charitable remainder holder of a charitable remainder annuity trust that held farm land, the college acquired fee simple title to part of the farm for cash and a promissory note.

Since the college seeking the opinion did not intend to use the property to satisfy its tax-exempt purpose, it planned to sell it. This college then entered into a joint-venture with a commercial developer. At the end of the transaction, the college would retain a minority beneficial interest in this transaction. In its Opinion Letter, the IRS stated that the college in question would not have to pay any taxes, including UBTI, at least until the point at which the transaction in question had been consummated. Presumably, it would later be taxed for profits received thereafter as a minority interest holder of the new entity.

THE ENTREPRENEURIAL APPROACH

Among a certain number of financially well-capitalized colleges and universities and a few well-endowed church groups, movement into wide-scale aggressive real estate investment and

The reasons for miscalculations in buy or sell decisions are numerous. Often, it is an immediate panic move. Attendance is down. Cash flow is perilous and endowment fund returns are disappointing. What to do?. . .Sell real estate?. . . What else?. . .Sometimes no other answer exists; but often one does. Among other possibilities are sales and leasebacks, joint-ventures, and ground leases. All three strategies are frequently employed alternatives to outright property disposition, straight forward property leases, or a trio of alternative deployment options.

development projects is a natural evolution of the need for asset diversification. This especially is so when the institution's underlying endowment holdings exceed $1 billion. Such entities usually treat their real estate subsidiary as a semi-independent grouping - almost like a normal commercial real estate development company. The only difference being that the sponsor usually has placed dedicated funds in the hands of its separately created real estate development entity. Accordingly, there is a strong fiduciary obligation involved in such a relationship, exceeding that associated with any publicly funded company.

A number of financially secure colleges and universities all over the country are diversifying their portfolios with real estate investments. These investments are not limited to property within the immediate campus, but can include office parks, commercial sites, and retail outlets in the towns and cities surrounding the campus. Let us pick a selective sample of states and examine these trends. All of these colleges and universities and many others like them will have significant need for sophisticated real estate counseling advice throughout the construction process.

In Arizona, the University of Phoenix is moving its northwest Valley campus to a new facility that will be four times larger than its existing campus. Paramount Partners is developing the two-story, 40,000 square foot facility on four acres in Phoenix. The new facility will more than double the number of existing classrooms, and provide administrative service areas and computer lab space. The University of Phoenix is the sixth largest private university in the country, with more than 250,000 students nationwide. Their niche consists of mature students who work full-time at the management level, with an average age in the mid-30s.

Arizona State University has plans to transform a Tempe strip center into an upscale mix of shops, restaurants, and offices, and a link between downtown and the university. The university is negotiating with developers who plan to invest $40 million in the facility. The entire project will include about 150,000 square feet of retail and 50,000 square feet each for restaurants and office space. Developers are signing an agreement to lease half the land from ASU and will pay ASU a percentage of the rent collected.

In California, a Toronto company, Lauridon Sports Management, will pursue construction of a 5,000 seat basketball arena and three ice rinks at the University of California, Riverside (UCR). The University could not afford to build the facility on its own. Lauridon would pay UCR rent and let the school have use of the rinks and give input on the facilities design. The deal is worth approximately $20 million.

Ventura, California, will have a new college campus, California State Northbridge, constructed on a property which was formerly a state hospital. Approximately $6.5 million will be needed in the fiscal 1998-1999 state budget to convert the buildings to classroom and administrative facilities. To reduce costs, Cal State planners will seek partnerships with private firms interested in leasing space at the campus.

Pasadena City College is building a new gymnasium as part of the final $21.7 million phase of the community college's 10-year improvement project. The 65,000 square foot athletic facility will include several basketball courts and a fitness center, plus classrooms for sports medicine and other physical education courses. The project was financed with $19 million in state bond funds earmarked for higher education.

In Connecticut, Yale University and a well known real estate developer have acquired the Whitney Grove Square office building and adjoining retail shops at Whitney Avenue and Grove Street. Under the contract, Yale will own the office tower, while the developer's limited partnership will own the retail stores at the ground level. In 1984, Yale sold this same property to Whitney Grove Square Associates Limited Partnership to facilitate its development. Yale was a large backer of the partnership, investing about 30 percent of the funds initial capital.

In Illinois, The University of Illinois has expansion plans of approximately $700 million on the Chicago campus. The project will include university buildings, student and private housing, parking, and new commercial development on 30 acres of vacant rundown land. The University intends to create a new south campus with a goal of getting staff, faculty, and about 25 percent of the student body to live in the area, in an effort to clean up the vicinity where it owns 15 buildings along the Maxwell and Halsted area.

In Massachusetts, Harvard University secretly purchased land in the Boston blue-collar area of Allston in the late 1980s through an undisclosed intermediary. The disclosure of these purchases was received with hostility from the city and the residents in Allston. The mayor specifically was angered by the secrecy and residents in Allston felt they deserved a premium for their property which would be used by the well-endowed Harvard. Total purchases include 14 parcels comprising 52 acres. The true purchaser was kept secret in an effort to keep prices down. Harvard owns 220 acres in Cambridge and now 192 acres in Allston.

Over the past five years, Northeastern University in Boston has developed $100 million worth of real estate. The University has a 55-acre main campus in Boston and a 200-acre campus in suburban Ashland, Massachusetts, which serves as its planning and educational retreat center. According to school officials, most of the urban development has been in dormitory housing, an effort to establish affordable housing options for students, as off-campus housing costs rise and may be a deterrent for potential students. Northeastern's intent is to blend into the community surrounding its Huntington Avenue campus in Boston. Neighboring Suffolk University is continuing its expansion in downtown Boston, and has purchased the former Department of Public Health building. Its goal is to convert it to student housing.

Plans currently are being made for the biggest real estate development project in Boston's history. There are to be several buildings, one taller than the Prudential Tower, in the south Boston waterfront district by South Station. The combined hotel, office, and research space would total three million square feet and cost approximately $600 million. TUCD Inc., a for-profit subsidiary of Tufts University, is working with the Hines Interests Limited Partnership of Houston to develop the complex.

The University of Massachusetts Medical Center recently increased its real estate holding in the purchase of the Massachusetts Biotechnology Research Park, a 75-acre park, with the purchase of an 80,000 square foot research building, located west of the University of Massachusetts campus for $3.83 million. The building was recently valued at $9 million by city assessors. The University still has plans to build a $12 million, 32,000 square foot neuropsychiatric research center on grounds near Worcester State Hospital.

The University of Missouri decided to buy 36 properties on the south edge of the University of Missouri-Kansas City campus for $1.32 million. The intention is to clear the two-block area for use while a new parking structure is built. The decision has been met by opposition from residents living in the houses to be demolished. The University, under the State of Missouri's power of eminent domain, has the power to acquire buildings even if owners do not want to sell.

In New York, Cornell's Business and Technology Park, a real-estate link between Cornell University and private commerce and research entities, currently owns 200 acres, with 76 tenant companies, the majority being technology companies. There is a two percent vacancy rate. Private funds in the facility are valued at approximately $23 million. Park amenities include a child-care center, a medical clinic, the main U.S. Post Office for Ithaca, and Federal Express, all bordering a three-acre pond.

In Wisconsin, a real estate developer, Told Development, has donated a $17.4 million, two-story, 156,000 square foot building in downtown Eau Claire to the University of Wisconsin-Madison School of Business. Once the mortgage on the property is paid off it should generate about $1.7 million yearly in revenue for various UW-Madison programs. The building's one tenant, a firm which manufactures high tech components, has a lease which extends through the mortgage expiration. The donation is one of the largest ever made to the University.

Smaller educational institutions who choose not to establish their own real estate development arms still possess a number of opportunities for entering into limited scale real estate development entities, either on their own or in conjunction with a joint-venture partner. Such well defined small scale development should compliment the academic strength of the educational institution involved. Obvious examples are scientific research parks linked to academic physical science and computer science departments and outreach health care facilities linked to university hospitals. In any such venture it is important that the underlying professors involved possess sufficient academic and entrepreneurial skills to make the university supported facility financially viable. The failure of so many of the first wave of university sponsored research and industrial parks is attributable to forgetting this precept.

A number of financially secure colleges and universities all over the country are diversifying their portfolios with real estate investments. These investments are not limited to property within the immediate campus, but can include office parks, commercial sites, and retail outlets in the towns and cities surrounding the campus. All of these colleges and universities and many others like them will have significant need for sophisticated real estate counseling advice throughout the construction process.

In another area of controversy, many church buildings are officially designated as historic by the relevant landmark commissions. Normally, alterations to historic sites must be approved by appropriate governmental agencies and this, in many cases, can delay projects for years. Nevertheless, because many pieces of church property occupy downtown, potentially upscale, choice commercial locations, the effort of negotiating with landmark commissions and other regulatory agencies can be worthwhile. Moreover, many of these historic sites offer tantalizing opportunities for public-private partnerships. This adds to their attractiveness and marketability.

Higher education is by no means immune to arduous challenges regarding its real estate holdings. On the private college and university side, tuition increases and financial aid subsidization requests have forced these institutions to search for profitability and efficiency in all aspects of their operation. On the public college and university side, legislative budget cuts and increased student insistence upon smaller class sizes, sparked by the realization that a quality education is essential for most worthwhile positions these days, have placed huge demands for the proper utilization of real estate.

THE COMING OF VIRTUAL UNIVERSITIES

In addition, it is a cold, hard fact of life that the Internet and the communications superhighway, over-hyped as they may be in some regards, do possess the potential to alter radically, most often negatively, the space requirements of a number of colleges and universities. Very few institutions have looked realistically at the real estate changes being sparked by instantaneous technological advances. Make no mistake! A revolution in higher education space allocation is forthcoming.

Distance learning is the general name for the trend in education which includes the establishment of "virtual universities." The range of technology that is included in distance learning is varied, and includes both high and low technology delivery mechanisms. On the low-tech end, are correspondence and television courses that do not allow for synchronous interaction between the teacher and student. The high-tech end of the spectrum can include fully interactive remote delivery systems implemented via electronic teleconferencing or sophisticated fiber optic networks, as well as the Internet or World Wide Web as a means for classroom instruction and student interaction.

Universities participating in this trend are not limited to the big names and range from Pike's Peak Community College in Colorado Springs, Colorado, to Stanford University, California. Degrees range from Masters of Science in Quality Assurance to MBAs to undergraduate degrees for 18 year-olds and baby boomers, to professional degrees for parents working full-time. Classes taught range from turf management to geography, accounting, history, and Latin.

Also significant for new virtual universities is the wealth of corporate funding available. Companies like Intel and Sun Microsystems and endowments like the Sloan Foundation, are eager to make donations to technologically innovating programs like virtual universities. The best example is the California Virtual University, benefiting from its deep pocket location in Silicon Valley. Such companies are also interested in using these systems of training their own employees and developing their own continuing education facilities. The advent of the virtual university and the high technological requirements needed to service the program look to be prime opportunities for high-tech companies to make tax deductible contributions for development, as universities look to expand their endowment.

The cost benefits of distance learning are only felt as enrollment is increased and universities are able to realize economies of scale in their technology investment. U.S. colleges and universities spend approximately $12,500 per local student, while distance students typically cost the university approximately $350 annually. This amount can increase exponentially as the number of enrolled students decreases. It is likely that once the initial investment in the technological infrastructure is complete, and universities have consistent enrollment, costs should drop dramatically and reflect the lower operating expenses they incur. The overall impact on college and university needs is not yet completely clear. Certainly good outside real estate real estate counseling advice will be needed.

As competition among educational institutions for quality, paying students intensifies and the service demands of all of the constituencies served by the higher education community increase in our consumer society, a number of colleges and universities have expanded their role in involving themselves actively in the neighborhood and municipality in which they are situated. Purchase and renovation of adjacent neighborhood real estate is often part of such a plan.

Many times the university's official linkage with the surrounding community is announced with great public fanfare. Often the "town and gown" partnership can be tied to active participation in the appropriate, already incorporated, neighborhood association. Seeking to stabilize deteriorating communities around the campus before they become a student recruitment deterrent, some forward-looking educational institutions are providing substantial housing subsidies to faculty and staff willing to relocate there. Contractually, they commit the institutionally contributed subsidies to rehabilitating the exterior of their homes and to establishing or improving their gardens. Frequently such plans specify that the educational institution has first refusal rights on re-purchase if the faculty or staff member later chooses to sell the house. In similar manner, if the institution purchases neighboring properties for its own administrative or classroom purposes, it stands to profit significantly if the general neighborhood appreciates in quality and a sales strategy for the offices in question becomes appealing.

KEY REAL ESTATE COUNSELING PRINCIPALS

Whatever type of outside real estate venture is pursued by a denominational or educational institution, two overriding concepts must be kept clearly in mind. First, risk is a factor in all profit-driven real estate ventures. Colleges and universities, especially those with limited endowments, must be very prudent in exposing at-risk funds to speculative ventures.

Second, excursions into profit making ventures by denominational and educational entities often can cause resentment on the part of local merchants placed in competition with an educational entity that may not need to pay property or revenue taxes. Colleges and universities sponsoring hotels and restaurants have been particularly vulnerable to such complaints. The subject of taxable liability is becoming increasingly contentious between non-profit organizations and their sponsoring municipality.

Except for the entrepreneurial approach as a semi or total autonomous investment vehicle, the use of real estate by a denominational or educational institution must be carried out in accord with the statutory and charitable mission of the institution in question. Since the trustees of any non-profit organization are the definers, keepers, and refiners of the institutional mission, they should examine scrupulously all aspects about buying, selling, constructing, and renovating property before a final decision is made. In a similar manner, the real estate activities of the institution should always agree with its educational and financial strategic plans. Counselors of Real Estate have an important and most challenging role in helping non-profit organizations adapt to today's changing real estate environment. REI

NOTES

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CRE PERSPECTIVE

Will Real Estate Be Overbuilt Again?

by Richard F. Muhlebach, CRE, CPM

Even as the real estate industry and the U.S. economy in general continue to enjoy prosperity and growth, real estate experts and field personnel alike are already beginning to worry about the next down cycle.

And to some extent, these concerns are justified. Real estate is a cyclical business. There have been four real estate cycles since 1969, and even with the significant changes the industry has experienced in the last few years, that pattern is unlikely to change.

Does this mean that we are already on the road to another real estate crash equal to the disaster of the early 1990s? Absolutely not!

A Different Sort of Expansion

Most of the conditions that contributed to the overheated atmosphere of the 1980s no longer exist and are unlikely to repeat themselves—

- Despite recent capital gains reductions, federal tax laws do not provide unsupported incentives to build regardless of demand;
- Overeager institutions and foreign investors have learned that buying without regard for cash flow is a prescription for trouble; and
- Banks and bank regulators have adjusted lending criteria to ensure that building pro formas bear a relationship to reality.

Still Room for Miscalculations

Nevertheless, some real estate markets may already be moving from improvement toward overheating.

- According to Torto Wheaton Research, the construction of office space, which came to a virtual halt in 1992, has more than quadrupled between the last quarter of 1992 and the last quarter of 1997, and jumped by almost 50 percent between mid-1997 and mid-1998. While this new construction is less than 50 percent of the volume during the boom of the late 1980s, the trend has been consistently upward for the last nine quarters. And while absorption continues, vacancy declines are already slowing in suburban office markets.
- Anchored malls have experienced a similar fluctuation with national average price per square foot falling by 15 percent from 1990 to 1993, to a national average of $96.24 per square foot in fourth quarter 1993 before rebounding to $116.69 in second quarter 1998, according to the *National Real Estate Index*.
- Apartment properties respond more rapidly to real estate cycles because of shorter lease terms and easier construction of new supply. Consequently, multi-family has already shown a 29 percent gain in price per square foot from 1992 until late 1996, and reached a decade high average national price of $83.38 per square foot, according to the *National Real Estate Index*.

If real estate cycles are the inevitable result of the industry's structure and entrepreneurship, we, as real estate practitioners, should not just sit back and accept that another bust cycle is coming over the horizon.

Not Making the Same Mistake Twice

To a great degree, the severity of future real estate cycles depends upon our willingness to exercise judgment and common sense in our activities, during both the up and the down portions of the curve.

The key is not **if** overbuilding will occur, but **to what degree**. The skyrocketing expansion of the mid-1980s was mirrored by the dramatic fall of prices in the early 1990s. In contemplating real estate cycles, it is important to remember that the height of the upward curve usually dictates the depth of the decline. If we can exercise restraint during the good times, we can, in all probability, ensure that the bad times will not be as bad after all.

Arming Against a Repeat

The first, and perhaps the most important, line of defense against another real estate free fall are lenders and other capital sources. Lenders are the gatekeepers of the development process. Although underwriting criteria are already loosening somewhat from a year or two ago, caution remains the watchword. When developers must supply between 25 percent and 50 percent of the costs of their projects and have signed leases from between 20 percent and 60 percent of the space, overbuilding is much less likely to get out of hand.

Lenders and investors alike must pay more attention than ever to the information on which they base their decisions. Good market knowledge has always been the cornerstone of successful real estate development, but today personal computers, compact disks, and the Internet make good market data more accessible than ever before.

At the same time, local real estate managers and brokers who have always been a great source of the local market information that is the basis of real estate investment, have become even more sophisticated in applying their analytical skills to market and economic data. Thankfully, the days when real estate deals could be penciled out on an envelope are over—and the industry is better for it.

The renewed expansions of REITs and other securitized real estate has also attracted the attention of a battery of Wall Street analysts whose scrutiny has helped increase accountability and encourage restraint. The public market's tendency to recognize overbuilding quickly and immediately penalize share prices act as powerful deterrents.

Another vital factor in reducing the negative downturn of real estate cycles is recognizing that an accurate picture of supply and demand depends on more than the gross availability of space. Determining the suitability of existing space to meet the physical needs and interests of users is just as vital in assessing the demand for new supply. For example, in the strictest sense, the small, B and C office buildings found in many downtowns are part of the overall supply of office space. Yet, because most of these properties are unsuitable for today's business users, they can, in fact, distort actual vacancy rates. The market has already recognized this discrepancy and is supporting the conversions of these properties into housing, hotels, and other alternative uses.

And just as market-obsolete properties are subtracted from the supply, the demand for innovative new building options fuels the need for **some** new construction. Retail properties with multiplexes and other entertainment options or with life-style components that respond to today's market serve a real demand need, even at a time when some retail space is languishing.

Maintaining a Balance

It is little wonder, then, with so many factors to consider, that smoothing out the ups and downs of the real estate cycle becomes an almost impossible task. No expert can unfailingly predict the direction of future need perfectly enough to maintain the delicate balance of supply and demand. When long construction times, zoning requirements, and government regulations are factored into the equation, the accuracy of such predictions becomes even more suspect. However, what real estate professionals can bring to the next round of development and expansion is sound business judgment based on current, reliable data. In this way, we can help ensure that those never-ending real estate cycles are just minor waves on an upward course of prosperity.REI

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Counseling for Denominational Non-profits

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Golf Course Properties - Consultant, Appraiser, Advisor

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REAL ESTATE ISSUES

EDITORIAL CALENDAR

Fall 1998
Focus Edition - Public Sector Counseling

Winter 1998
Special Edition - Technology

Spring 1999
"Real Estate Issues Research Digest"
A Comprehensive Directory of On-going Real Estate Research Projects
(See submission form for entries on page 51 - deadline for submissions January 29, 1999)

Summer 1999
Articles on general real estate-related topics
(deadline for manuscript submission - March 15)

Fall 1999
Focus Edition - Counselors & the Law
(deadline for manuscript submission - June 15)

Winter 1999
Articles on general real estate-related topics
(deadline for manuscript submission - September 15)

See "Contributor Information" on page iii for information on submitting a manuscript or call Faye Porter at 312.329.8429

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REI INDEX OF ARTICLES

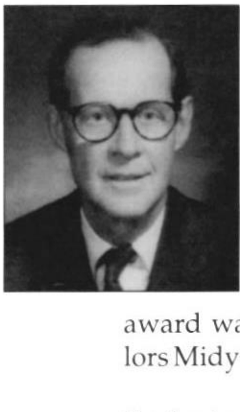
The ***Real Estate Issues "Index of Articles"*** provides over 100 alphabetical subject listings for articles published in the journal during its 22-year history, along with a second alphabetical listing of authors. To order your copy of this convenient reference, call **312.329.8427**; *(cost $3, plus $3 shipping)*. The *Index* can also be accessed through The Counselors' home page at **www.cre.org**

SUBSCRIPTION INFORMATION

Real Estate Issues publishes **four times per year** (Spring, Summer, Fall, Winter). To subscribe to ***Real Estate Issues*** or for additional information, contact The Counsleors at **www.cre.org**; 312.329.8427.

George M. Lovejoy, Jr., CRE, Receives 1998 Louise L. & Y.T. Lum Award

George M. Lovejoy, Jr., CRE, Boston, was named recipient of the 1998 Louise L. & Y.T. Lum Award for his distinguished contribution toward advancing knowledge and education in real estate counseling. Established by the late Y.T. Lum, CRE, the award encourages the continuing professional education of those engaged in real estate counseling through an understanding and advancement of its principles, theories, techniques, and practices. The award was presented during The Counselors Midyear Meetings held earlier this year.



Professionally, Lovejoy serves as president and CEO of Fifty Associates, a real estate investment company founded in 1820. He is a 43-year veteran of the real estate business, having begun his career with the Boston-based Minot, DeBlois, and Maddison. Prior to joining Fifty Associates, Lovejoy served 12 years as president and CEO of Meredith and Grew. He is a trustee of MGI Properties, a director of various Scudder mutual funds, and a director and past chair of the Boston Municipal Research Bureau. Civically, Lovejoy is former chair of the Massachusetts Advisory Committee for the Nature Conservancy and a past president, trustee, and member of the Board of Governors of the New England Aquarium.

Described as a "leader among leaders," Lovejoy was recognized for his "generosity of spirit, nobility of character, and for living a life which has truly made a difference." Lovejoy has been an active member of The Counselors of Real Estate since his invitation to membership in 1969. He is currently the chairman of The Counselors Strategic Planning Committee and served as national president in 1982. In 1991, Lovejoy received the John R. White and James D. Landauer Award--another of The Counselors' prestigious awards honoring excellence in the real estate profession.REI

Research Project Submission Form

for inclusion in the 2nd Annual

1999 Real Estate Issues Research Digest

COMPLETE AND RETURN BY JANUARY 29, 1999

(please type or print LEGIBLY)

Project No. ______ Project Category* for Indexing ______________________________

(*see list of categories on reverse side)

Title: ______________________________

Name of your organization and department: ______________________________

____

Client or funding source: ______________________________

____

Amount of funding: ______________________________

Brief description of research objective: ______________________________

____

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____

Brief description of research methodology: ______________________________

____

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Contact's name: ______________________________

Address: ______________________________

Projected completion date: ______________________________

Telephone: ______________________________ Fax: ______________________________

E-mail: ______________________________

❑ Yes, I would like to reserve ___ copies of the *Real Estate Issues Research Digest* at the **discounted price of $20** each. *(Check enclosed payable to: The Counselors of Real Estate)*

Fax (312.329.8881) or **mail your completed form(s) to:**
Faye Porter, c/o The Counselors of Real Estate, 430 N. Michigan Ave., Chicago, IL 60611

All forms must be returned by JANUARY 29, 1999; projects reported after that date cannot be included. (The *Real Estate Issues* Editorial Board retains the right to edit submitted forms and to reject submissions that it feels do not meet the criteria for inclusion in the *REI Research Digest*.)

Cut here, complete & mail or fax

CATEGORIES FOR INDEXING RESEARCH PROJECTS

For Indexing purposes, select the topic category your project should be listed under. Select only one category per project. If your topic is not listed, list it under "other" with its proper heading.

Real Estate Research as it relates to:

Accounting
Arbitration
Asset Management
Bankruptcy
Brokerage
Capital Formation
Capital Markets
Computers (see also Technology)
Condominiums
Demography/Demographics
Development
- *Community*
- *Multi-family*
- *Public/Private Joint-Ventures*

Disposition
Easements
Education
Eminent Domain
Environment
- *Sick Building*

Feasibility Analysis
Financing
Future of Real Estate Industry
Government
- *Federal Reserve System*
- *IRS*

Historic Structures
Hotels
Housing
- *Elderly*
- *Financing/Mortgages*
- *Foreign*
- *Mixed Income*
- *Multi-family*
- *Public*

Industrial Real Estate
Inflation
Information Revolution (see Technology)
Insurance Companies
International
- *Investment*
- *Lending*
- *Markets*
- *Risks*

Inventory
Investment Analyses
- *Institutional Investment*

Land Use
Leases
Legal Issues
- *ADR (Alternative Dispute Resolution)*
- *Expert Witness*
- *Litigation*

Market Analyses
- *Trends/Relationships*

Medical
Military Bases
Money Markets
Mortgage Financing
Office Markets
- *Corporate Headquarters*
- *Occupancy/Vacancy*

Parking Facilities
Pension Funds
Politics (see Government)
Portfolios
Product Absorption
Property Management/Values
Proximity Impact Analyses
Public Housing (see Housing)
Public/Private Sector
Rates - *including:*
- *Cap Rates/Yields*
- *Discount Rates*
- *Interest Rates*
- *Internal Rate of Return*

Real Estate Analyses
Real Estate Counseling
- *Counselor-Client Relationship*
- *Ethics* (see Real Estate Ethics)
- *Fees*
- *Non-Profit Organizations*
- *Partnerships*
- *Public Process*

Real Estate Cycles
Real Estate Ethics
Real Estate History
Real Estate Investment
- *REITs*

Real Estate Syndication
Real Estate Valuation
Redlining
Regulations
Relocation
Rent
Retail (see Shopping Centers)
Revitalization
Securitization
Shopping Centers
- *Factory Outlets*

Site Selection
Sports Facilities
Storage Facilities
Suburbs
Taxation
- *Flat Tax*
- *Sec. 1031 Exchange*

Tax Reform
Technology
Telecommunications
Thrift Industry
Timesharing
Transferable Development Rights
Urban Real Estate Markets
Zoning

OTHER: *please list topic heading:* ____________________

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