

A Real Estate Planning Model for the Public Sector

Part I: Supply & Demand Phase

The White Paper Series

UGL Equis Corporation publishes a series of informational white papers providing the framework for a broad understanding of real estate issues facing government and public sector agencies.

The Authors of This White Paper

With over 26 years of practical experience in the commercial real estate industry and a primary focus on leasing, portfolio management, investment, acquisition and disposition, and advisory services to state government, public sector agencies and corporate clients, Senior Vice President **Elliott Farber** is currently engaged in providing strategic consulting services to the State of California, spearheading occupancy strategy for 32 million square-feet of state-owned property. In Wisconsin, Mr. Farber evaluated 90 million square-feet of state owned assets. His analysis and recommendations will allow the assets to function optimally and cost effectively, and are currently being implemented by the UGL Equis project team.

Vice President **Christopher Larson** is a key member of the Government Services Group (GSG), supporting the California and Wisconsin initiatives in partnership with Mr. Farber. Specializing in government, non-profit, schools, universities and health-care providers, Mr. Larson - over the past 15 years - has gained extensive experience providing tactical expense management, corporate asset management services and has established bench-marking standards of accountability and professionalism. He is the author of *“Real Estate: A Financial Tool to Address the Ongoing Fiscal Crisis Facing Not-for-Profit Organizations and Municipal Entities.”*

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I. Identify Customer Need

Key Variables:

- Space Action Request
- Space Requirements
- Headcount Projection

The problem: State and municipal property assets are often de-centralized to such a degree that accountability is lost among a multitude of agencies, administrators/financial officers, boards and public commissions whose expertise rests in other areas outside of the real estate function.

At the Federal level the situation is even more acute: agencies do not maintain complete or accurate inventory information on real property or their use and condition. The cost to maintain underused or unneeded Federal properties is enormous. Although many of these properties may not be in actual use, they have significant day-to-day operational costs, -- maintenance, utilities fees, and security expenses.

It is a common problem for state and local government as well. The resulting lack of coordination, internal oversight, policy planning or advantageous co-location of agencies/groups that collaborate, contributes to missed opportunities for disposing of unneeded or under-performing portfolio assets; addressing the issues and challenges associated with extending or terminating a lease; making alterations to current space in order to accommodate current needs, or the decision to lease or own in order to achieve the economies of scale. We see the biggest challenge facing public sector agencies and state government is the means to counter the lack of inventory information and extract value from real estate assets by administering real estate services more efficiently.

In recent years, government agencies have come to recognize that the most expeditious means to restore overall coordination, reduce costs, free up capital for other initiatives necessary to make timely, cost-effective decisions, and mitigate risk in a time-sensitive manner is to engage a real estate service provider with deep background to formulate a Strategic Plan for portfolio management, brokerage, project services, facilities management and lease administration.

By helping State real estate administrative staff take a long-range view of planning over the short-term, “quick-fix” approach the service provider often becomes an “adjunct” real estate advisory department, essential to centralizing holdings under one umbrella, building a compatible, fully integrated data management platform, and identifying feasible lease/buy alternatives and the reduction of obsolete or scattered-site facilities. The partnering concept is critical to accomplishing current and long-term objectives and is executed with a good understanding of the risks involved for both sides.

To ensure that critical steps are undertaken in an expeditious manner in order to secure the right space, the service provider assists the agency with the formulation of a comprehensive needs analysis accompanied by a preliminary project statement delineating:

- i. Scope of work to be performed;
- ii. Tenant improvements (TI) to be negotiated;
- iii. Move costs;
- iv. Amortization debt analysis (inclusive within the Total Cost of Occupancy (TCO));
- v. Schedule, budget and cost approval;
- vi. Facility management (FM) issues.

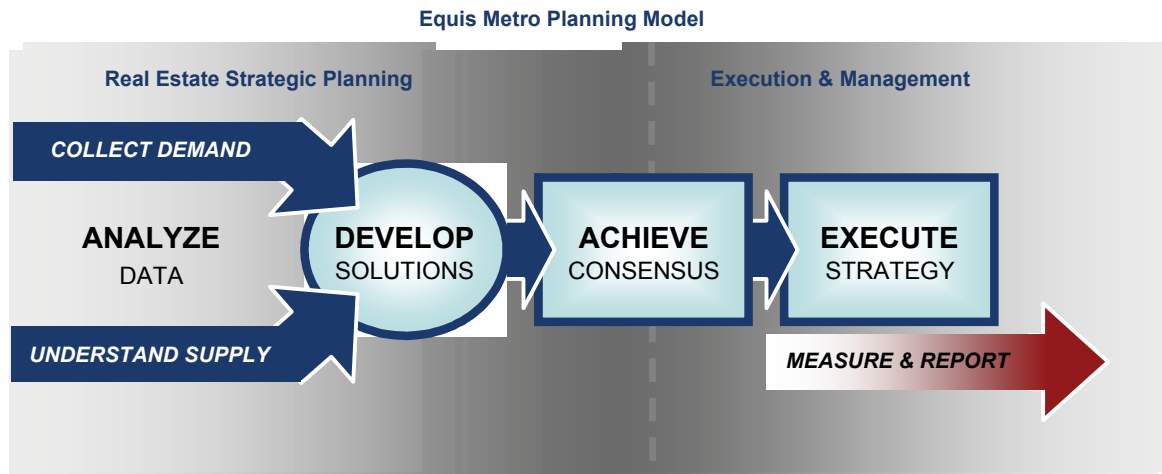
II. Build the Business Case

Key Variables:

- Budgetary Approval
- Estimate of Costs
- Justification for Request
- Understanding the Market

A public entity business case can be created around hard, tangible elements — return on investment, cost of capital, identification of funding sources, hurdle rates, worker productivity, energy costs, long-term operations and maintenance concerns and final budgetary approval — but within the real estate paradigm, the critical issue is a strategic fit of assets into the overall supply and demand plan, more specifically tied to the plans for the individual agency or department.

The proper alignment and allocation of owned or leased assets and land holdings contributing to sustainable process improvements must be viewed and analyzed within a “Supply & Demand” methodology that has been tested and proven across a wide spectrum of state and Federal governmental agencies; one that will meet a stated goal of securing the right space, at the right time for the right price.



The **Supply Analysis** begins with a Team of Account Managers and Transaction Advisory professionals collecting and assessing data points about current occupancy and future space needs and formulating a geographic or metro view of the available (existing and proposed) supply of real estate from each of the state or municipal agency decision makers. A review of current business plans and interviews with key officials within the public agency responsible for executing real estate strategy, and an accurate inventory of owned assets provides the foundation of understanding the Total Cost of Occupancy (TCO) of each location. Recommendations for lease versus own scenarios, co-location, and cost avoidance, and a program schedule for future implementation are achieved during this phase.

Demand Analysis planning captures information systematically and tests and validates the need for space using standardized methodologies and tools. In this phase, all elements of future workplace functionality are considered; current occupancy inefficiencies identified and evaluated; recommendations for implementation of a set of best practices standards typically developed over time by national trade associations like the Building Owners and Managers Association (BOMA).

The Demand Analysis includes comparative metrics of office utilization (square-foot per employee); cost metric (cost per employee; cost per square-foot; gross annual rent obligation) measured against industry benchmarks and incorporated into the final space planning recommendations incorporated into the master plan.

By matching the supply of space (leased and owned assets) with the demand for space (agency and department usage) the end deliverable is a recommendation of projects (new leases, lease renewals, consolidation, dispositions, etc) that should be conducted to reduce Agency costs or release capital.

For the City of Sacramento, CA, Phase I, of a two-phase strategic state-wide property asset portfolio management plan, UGL Equis managed a multi-disciplinary team of real estate consultants, facility management experts, analysts and finance specialists to determine real estate supply, demand, costs, opportunities and future management approaches.

The Government Services Group (GSG) delivered recommendations for re-aligning the real estate portfolio diagramming hundreds of millions of dollars in potential savings.

Among UGL Equis' key recommendations were to:

- Develop and implement a space management program to help manage occupancy needs over time
- Create performance metrics to measure performance
- Refine space management guidelines and methodology for implementation
- Establish move management closeout process for major capital projects
- Create mechanisms to track new project data

One of UGL Equis' most significant findings involved a proposed Sacramento project that was projected to cost \$611 million. UGL Equis recommended the State re-examine this project, that could result in \$306 million in savings. The results of our analysis revealed that there was more space available than originally thought. Additional recommendations focused on benchmarking, staff and organizational alignment, process and statutory implications.

The GSG recommendations have all been approved and are currently being implemented.

Understanding the Market

Critical to sound portfolio administration is the research function -- vital to the accumulation of accurate data and necessary to understanding the market and formulating investment and management strategies. Local market knowledge is achieved at two succinct levels (1) through interaction with brokerage professionals working the streets and canvassing properties, lease comparables, current inventory, and the prevailing vacancy, absorption and asking rental rates. (2) Web based, subscription commercial real estate listing services like LoopNet and the CoStar Group monitor local and national markets. CoStar tracks 1.9 million properties and 500,000 commercial listings in the U.S. and Great Britain.

The LoopNet on-line market place lists \$395 billion in property for sale, and 3.2 billion square feet for lease. In addition to CoStar and LoopNet, other web-based providers both local and national in scope including Claritas, Hoover's, and Lexis-Nexis offer users related business intelligence, SEC filings, D&B reports, and archival news material. ArcView, GIS and ESRI produce various customized projects utilizing desktop mapping software (i.e. business locations, traffic volume, employee locations, and thematic maps relying on current census data).

III. Frame the Requirement

Key Variables:

- Preliminary Strategic Plan
- Lease vs. Own Analysis
- Sensitivity Analysis
- Compare Plan to Benchmark and Standards

Framing the real estate requirement is commonly understood in terms of executing a *process* necessary to achieve desired outcomes. Sustainable process improvements to real estate management are viewed as longer-term solutions creating better cost positions that reducing spending on facilities and services and higher standards of internal customer service.

At the heart of the aforementioned Demand→Supply model is the common denominator of a portfolio wide review and measurement of the entity's leased or owned real estate assets. Real estate is generally not viewed as a substantial growth investment opportunity and has little operating leverage to achieve economies of scale. However, ownership of real estate as an asset offers some positive financial advantages, primarily as an investment with an unlimited lifespan, but for public sector entities it must be considered within the context of strategic or residual value and core vs. non-core. In other words, is this core to our overall real estate strategy? The best way to answer this question is to compare the value of own vs. lease by creating a model weighing the Total Cost of Ownership (TCO) alternatives with other strategic factors.

The model, once created, can be measured through Sensitivity Analysis - a valid method of assessing critical assumptions, the uncertainties of the outcome of the process, the supply of space (leased and owned assets) with the demand for space (agency and department usage) and the strategic, financial, and short-term/long-term justification for leasing or owning.

The benchmarking report provides an implementation plan to prioritize and achieve industry best practice benchmarks across the portfolio and includes a gap analysis based on current practices in relationship to the industry.

IV. Summary of Part One

Thus far, we have examined the key issues and challenges facing public sector real estate administrators as they seek to maximize real estate efficiency, achieve flexibility, and make knowledgeable, informed decisions about purchasing, operating and disposing of assets.

Property decisions should never be made in a vacuum. The opportunity to deploy an asset or a group of assets should be based on knowing when the time is right then developing a sound business case -- the diagnostic tool to strategize an action plan. It requires a detailed review of processes and practices, and divesting at the optimum moment. We recommend conducting a Supply & Demand Analysis as the most expeditious means to support the strategic direction for realigning the real estate portfolio. Quality issues, achieving standardization of procedures, end-to-end consistency, and identifying gaps in the existing real estate processes are established in this phase. As the next step, a written Request for Proposal (RFP) is issued to outside service vendor firms to present their qualifications. A compelling proposal, spelled out in a sequence of issues, will elicit responses and provide substantial evaluation criteria for the final selection. **This will be discussed further in Part II.**