

## A Real Estate Planning Model for the Public Sector Part II: Transaction Execution

### 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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As public jurisdictions re-evaluate their portfolio holdings, policy-driven criteria and strategies for determining which properties to keep, the underutilized assets to put on the block, and the means to extract the most value out of each must be fully developed. Effective management of public property requires clearly enunciated principles, high levels of administrative oversight, technical savvy, forecasting, and sound policy. As a rule of thumb, it is far less costly in the long run to retain outside expert advisory on managing real estate assets than risk expensive mistakes and oversights. Step one is the issuance of an effective RFP to private sector firms. Typically, the local government RFP will be framed around a general theme, e.g., “Strategic Real Property Asset Portfolio Management Plan, and Real Property Brokerage Services.”

## I. Prepare RFI/RFP

Key Variables:

- Standardized Approach
- Key Data Elements
- Frame Concessions

First, it is necessary to determine the requisite (statutory or otherwise) lease language and provisions before a public sector RFI/RFP is released.

To ensure clarity and fairness in the RFP and contracting processes, establish the offering parameters and build a database of potential contractors including (1) firms currently doing business with the agency; (2) a direct solicitation to brokers, landlords and developers; and (3) indirect solicitations utilizing on-line resources, commercial databases, websites etc., use this list for distribution and notification.

Prepare and send a standardized Request for Information (RFI) to screen the qualifications of service firms identified from the private sector. Issuance of an RFI is an important, but often over-looked first step in the qualification process. Following this simple procedure can save hours of evaluation time, and help to eliminate unqualified vendors and narrow the choice down to a “short list” of firms to receive the formal RFP.

Issue the Request for Proposal (RFP). Ideally, the RFP should go out eight to ten weeks before the requested submission date. Proposal writing is a detailed and intricate process. The extra time will allow potential vendors to better understand key issues and requirements as they craft a well thought out, cogent response.

A common shortcoming of many State-issued RFPs occurs when the State attempts to define how the study should be carried out by defining the order, tasks and timeframes for the study. This results in the service provider becoming constrained by the State when it provides too much detail relating to the approach. It is recommended that the State focus its efforts on defining the desire Scope and Deliverables.

Schedule a formal bidder's debriefing seven to 10 days after the issuance of the RFP to respond to vendor questions likely to arise. Agency staff responsible for real estate administration should be present at the conference.

Scoring Methodology. The process for evaluating proposals must be clearly stated and communicated to all potential bidders and reviewed once more at the bidder's Q/A session. A clear point system for scoring proposals will help ensure fairness and objectivity, and provide constructive feedback to unsuccessful bidders. There should be only one review panel for each RFP to ensure consistency in ratings and minimize appeals.

If the RFP process flowed seamlessly, the last step of selecting a vendor is narrowed to a small circle of qualified firms. It is not uncommon to request a final interview, in the event of two finalists whose qualifications are matched and no immediate decision can be made. In such a case, a third party, project stakeholder should evaluate the vendors independently and issue a recommendation.

## II. Generate Opportunities

Key Variables:

- Targeted Approach
- Analyze Landlord Finances
- Proactively Present Options

It is recommended that a core strategy of “creative leveraging” be employed during leasing negotiations with landlords and ownership groups in order to unlock potential savings. Too often, public agencies are unaware of the degree of leverage they may have as highly-coveted “credit tenants,” who, in the past, have typically committed to longer lease terms with fewer concessions, demands for free rent or scarce tenant improvement (TI) dollars than private users. For these reasons, Government tenants are often referred to by landlords as “evergreens.”

The key point: Leverage good credit history and existing landlord relationship to achieve valuation benefits and risk minimization. Gaining this kind of leverage is often predicated on *knowing* the market and identifying alternative space at potentially lower costs per square-foot —then collating the accumulated data to illustrate tenant’s available “stay or go” move options to the landlord or owner.

By focusing solely on the rental rate, a tenant could actually stand to lose multiples of the negotiated savings. Among the myriad of pages that comprise most lease documents, there are opportunities in other less proscribed areas to achieve significant tenant savings, ranging from monthly parking space fees and rooftop access rights, identifying and correcting deficiencies in base building conditions, to sublease rights and termination options.

It is also very important for the tenant to understand and utilize the vendor’s Project Management consultation tool kit for proposed build-outs, new construction or workplace integration planning arising during lease negotiation. An integrated team that includes a project manager and brokerage advisors facilitates more aggressive negotiation and avoidance of costly mistakes down the road by helping to accurately identify both short, and long-term space and infrastructure needs. By engaging the PM team (or service) early on, landlord cost estimates and oversight fees can often be mitigated. Too often there have been situations when project management issues are not considered until after the lease documents have been signed.

### III. Negotiate

Key Variables:

- Proposal Scoring Matrix
- Analyze Offers
- Compare to Plan/Metrics

Whether the building is owned by a Real Estate Investment Trust (REIT) or if it is privately held, taking advantage of current opportunities and capping risk, requires sound negotiating strategy. Further, the time it takes to renegotiate lease terms (if managed correctly), with tenant improvements (TI), and document review, will require more time than what many tenants may actually realize at the outset. Knowledge and timing equal power. It is imperative to dedicate the proper amount of time to analyze lease versus buy alternatives, the Total Cost of Occupancy (TCO), e.g., rent, moving costs, amortization, TI's, etc., and execute a negotiating strategy. Savvy tenants gain leverage when landlords believe the occupier is exploring alternative leasing scenarios in a competitive market. As the lease expiration date winds down, landlords know that a tenant's ability to occupy alternative space becomes more difficult. The landlord improves his bargaining position when the window period is closing.

A fully-engaged tenant representative understands the market drivers; e.g. the "lease comparables" and what is typically being offered by landlords and building owners of similar properties in the immediate area – the typical asking rental rates and market incentives including (but not limited to) rent abatement and the availability of TIs and negotiating a lease that will allow enough flexibility to accommodate unexpected changes in the future.

Most importantly, the tenant rep's thorough understanding of the landlord's motivations and his margins - gleaned from the "Tenant Replacement Cost Analysis (TRCA)" - will demonstrate the bottom-line impact of acquiring a new tenant at greater than market rates versus the easier choice of renewing the existing lease. Using the landlord's financial assumptions, the TRCA is irrefutable when the "down time" of unoccupied space, the associated lease-up costs for new tenant are weighed against the preferable options of accepting an amount that is equal to or greater than the cost of replacing the current occupier on a Present Value basis. Landlords rarely present a market-rate offer to the existing tenant until they are reasonably satisfied that the tenant is seriously considering relocation.

Expert representation creates the competitive environment among landlords necessary for the public agency to achieve the highest cost savings through effective negotiating strategy.

#### IV. Close Transaction

Key Variables:

- Cover Key Lease Provisions
- Work Letter/Space Plan
- Legal Review

Closing requires disciplined and creative problem solving with focused and persistent attention to every detail. As the date of closing draws near, the space occupier, the real estate brokerage professional and other necessary representatives for the lessee and lessor will respond to changing demands and circumstances. The key lease provisions must be thoroughly analyzed (i.e., rent, spatial factors, TIs, abatement, if any, early termination, and TCO). Space plans, the Certificate of Occupancy, a statement of building conditions and maintenance issues (security procedures, ADA compliance, HVAC specifications and a final timeline of work projects completed should be assembled and distributed to all parties and the Legal Department engaged for full and final review of terms. The final step, following closing, is distribution and request for completion of the Customer Satisfaction Questionnaire from all parties.

## V. Document Transaction

Key Variables:

- Standardized Approach
- Assemble Templates
- Distribute and Store
- Standardized Approach
- Assemble Templates
- Distribute and Store

If all of the process steps have been followed correctly, the completed templates should constitute the majority of the documentation packaging. A hard copy file would contain every lease file organized in accordance with the Checklist process steps and be placed in a safe and “redundant” filing system. The package would include a “closeout book” for future tenant use. At this point, the completed transaction(s) will have conformed to a standardized approach and comply with relevant statutes and government protocols.

## VI. Administer and Maintain

Key Variables:

- Capture Critical Dates
- Billing/Invoicing Terms
- Data Integrity/Reporting

To facilitate smooth Lease Administration with the leasing process, the GSG assists its public sector clients through each step of the technology procurement process and provides strong technical knowledge of system architecture to ensure that the product with the best fit is chosen by the agency.

Information is then catalogued and integrated into a real estate database capturing critical date notification chains, billing/invoicing terms and schedules, and other highly detailed functions with multiple controls on accuracy. The model also utilizes multiple cross-controlling staff to transition an existing database and/or create a new database by abstracting from an existing hard copy library. Once the database has been set up, configured and populated, critical date management is automated through reports made from the database and distributed to the real estate team. When the database is highly accurate, management of these tasks is enabled to be highly responsive and accurate, as well.

Quarterly reporting is the best frequency to support a range of management decisions (short, mid- and long-term) without placing an undue burden on stakeholder time or scheduling. Of course, this frequency is recommended for ongoing services; meetings and contact periods are significantly more frequent throughout the initial transition to the service model.

Over time, the Lease Abstract has evolved from a simple depiction of the typical landlord/tenant relationship with financial lease information, to a more comprehensive work describing in greater detail the rights of parties in commercial real property transactions. In a nutshell, it boils down complex lease agreements to their most essential components and presents them in a succinct, easy-to-read report that eliminates fine print and legalese, while summarizing relevant data on everything from environmental information and parking situation to notable clauses and building contacts. Much of this data contained in the Abstract is critical to the valuation and lease administration of properties and portfolios. A hard copy in standardized format is then created for the lease file and a “soft copy” (scanned or data fields) is added to the database.

Other reporting tools include:

- Quarterly Performance Report – Detailed presentation that incorporates graphics to detail all portfolio developments over the preceding quarter, in light of metrics and targets.
- Activity Report – General overview of all ongoing, upcoming, and targeted activity for each property. This includes a brief description of the location’s characteristics,

chronological notes denoting relevant developments/ contacts/negotiations, and dates for all administrative, legal and project management activities.

- Lease Expiration Report - Relates the chronological order of the end dates of all lease agreements in the portfolio. Provides further details on the current rent, lease structure, and holdover provisions that may survive the expiration.

### **Data Management: A Case Study**

A full analysis of the (State/City/County) data management, tracking and reporting practices is reviewed against industry best practices and standards with the objective of achieving significant cost reductions. For the Commonwealth of Pennsylvania, the GSG created a comprehensive database of leased and owned office space and to develop a specific set of recommendations to improve space use efficiency and reduce costs. The study covered facilities, land and leases.

UGL Equis' objectives were to:

- Optimize occupancy of owned property and minimize vacant space throughout the portfolio
- Reduce real estate obligations through better decision-making
- Recommend improvements to overall management of real estate assets and supporting processes
- Develop strategic rationalization and regionalization plans for individual agencies, as well as implementation plans

UGL Equis provided a strategic planning and opportunity analysis, review and advice on policies and procedures, facility management consulting and data management services.

### **Solutions**

UGL Equis undertook the assignment in four major phases: Project Planning, Space Inventory and Data Management, Analysis of Leased and Owned Space, and Recommendations. The end result was recommendations for short term and long term cost savings, efficiencies and improved management of the leased and owned space. The team also facilitated the transfer of knowledge to help state staff understand the changes required to realize cost savings.

During the project, UGL Equis conducted 80 interviews, analyzed over 5,000 pieces of data and provided reports to DGS and other agencies. The team also visited 75 sites to assess operational conditions for space use, metro area planning, FCA development, and for portfolio analysis. The work phases are described below.

**PHASE I. PROJECT INITIATION AND PLANNING:** UGL Equis and DGS Project Teams launched data gathering and analysis of real estate processes, and in particular, data management and space inventory capabilities.

**PHASE II. OPERATIONAL DIAGNOSTIC:** During this phase, the team interviewed key staff to identify operating drivers, analyzed and correlated portfolio characteristics, assessed workplace strategies and identified interim cost savings opportunities. The team also reported on progress toward 60-day milestones, and developed preliminary recommendations for validation.

**PHASE III. DEVELOPMENT OF THE METRO AREA PLANS AND FACILITY CONDITION ASSESSMENTS:** Next, The team next conducted a deeper analysis of initial findings through working sessions with state representatives concerning departmental functions and processes. Topics included developing five metro area plans and completing Facility Condition Assessments (FCAs) for five buildings identified by DGS. Additional interviews were conducted with stakeholders not previously identified.



The team compared findings against benchmark data and best practices from the private and public sectors. In addition, the team identified specific leasing opportunities requiring immediate action, as well as opportunities for process improvements.

**PHASE IV. SYNTHESIS, FINAL ANALYSIS AND RECOMMENDATIONS:** The final phase was designed to validate the team's findings. The UGL Equis team prioritized recommendations, provided support rationale, and described how they should be implemented.

Where applicable, the recommendations were qualified as to the risk involved, the impact on DGS or others, the time and cost associated, and sufficient detail to begin implementation. The recommendations lay the groundwork for implementation

Security of data as housed in the host environment and accessed by Internet is the primary responsibility of the software and system vendor. Security and stability are factored into the software decision matrix alongside functionality and connectivity of the system.

### Selected Government Services Group Clients

<u>Client</u>	<u>Portfolio</u>	<u>Services Provided</u>	<u>Scope</u>	<u>Client Since</u>
State of California, Dept of General Services	40 Million Sq. Ft. Leased and Owned Properties	Strategic Planning	Entire State	2005
State of Pennsylvania	8 Million Sq. Ft. Leased Properties	Strategic Planning	Entire State	2004
State of Wisconsin 	85 Million Sq. Ft. Leased & Owned Properties	Strategic Planning	Entire State	2004
U.S. General Services Administration 	Transactions Assigned Individually 350 Million Sq. Ft.	Portfolio Management Transaction Advisory Project Services Audit & Recovery	28 States and the District of Columbia	1997

## Summary

There is a tendency among public sector agencies to view their real estate holdings as simply another cost that must be absorbed. However, real estate can become a strategic resource. All governmental bodies should consider how to capitalize on favorable market conditions to make real estate a contributor to budgetary goals. The real estate portfolio has important strategic implications because it is almost always the second highest operating expense after Human Resources and technology, but the decentralized nature of these holdings administered by various bureaucracies with little or no contact with one another often results in a lack of efficiency and coordination. The timing also has to be right. Whether the asset is a parcel of vacant land, an administrative office, industrial/storage facility, the likelihood of attracting credit-worthy private investors depends on how much capital costs may be at the moment, or if prospective investors considering the addition of a former public asset to their portfolio can find cost-effective alternatives in the private market.

An engaged, qualified tenant representation and Project Management team brings dedicated advocacy to the negotiation and can save the agency both time and money by assisting in proposal preparation, negotiations in the procurement phase, preparation of Best and Final Offers, negotiate lease or acquisition agreements, contract administration, and all other related essential services

The mission of the Government Services Group is to analyze the myriad of challenges facing public bodies and to provide recommendations for potential short term and long term cost savings, efficiencies and improved management of real estate holdings.