

Real Estate 101 for Government

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Maryland is just one among a growing list of state and local governments that have recently considered the sale of a visible and valuable public asset in the expectation of reaping a substantial cash windfall. As elsewhere, the decision to sell has stirred controversy and evoked concern about sale prices and the fiscal discipline needed to ensure long-term benefits. Will both be high enough?

A certain amount of concern is warranted. Government property accounts for a significant amount of public wealth. When officials decide to dispose of property, the transactions are not easy to undo and the resources can't be easily replaced.

While the sale of a signature property like the World Trade Center might grab headlines, the underlying trend is the real story—namely, that government officials are only now adopting a practice that private sector companies have embraced for over two decades—asset management.

This well honed process is designed to produce knowledgeable decisions about purchasing, operating and disposing of assets, but private sector models are not always applicable to or reliable in public sector settings.

How should government officials determine when, or even if, it is appropriate to sell assets large or small? What price represents a fair deal for the taxpaying public?

Property decisions should never be made in a vacuum. A building or a parcel of land is nothing more than a resource for achieving a vision of where the community wants to go and how it intends to get there. Since opportunities to deploy assets are countless, well-grounded decisions about their use can best be made through a disciplined plan that includes explicit policies, systematic procedures, and appropriate performance benchmarks.

When combined with incentives for government agencies to practice sound asset management, such a plan makes spotting underperforming resources reasoned rather than random. Ideally, it also recycles proceeds from asset sales to opportunities of superior strategic importance.

In 1999 the Maryland Department of Transportation assembled a panel of experts to assess the Department's real estate policies, practices and procedures. The Real Estate Advisory Group's final report to the Governor served as the framework for developing and implementing a comprehensive asset management plan to guide the Department's real estate decision making.

That plan spelled out a sequence of steps that still make good policy sense. Detailed understanding of the nature, extent and use of all assets is the first step to wise asset management. Once an asset is identified and classified as essential or non-essential to an agency's mission, its performance can be continuously measured against established benchmarks while its contribution to that mission is periodically assessed.

Nonessential assets, like office space in the World Trade Center, should not be carried unless they contribute on-going benefits or cash to the Department. Otherwise, sale or other disposal should be considered to divert the capital tied up in the property to more productive uses. Government agencies should always be scouring property portfolios to uncover latent opportunities in unused and underutilized assets.

Property appraisals from independent experts help keep asset management decisions honest and effective, but aren't the only measure that needs to be considered. Cash offers—no matter how substantial or enticing—should also be measured against the benefits of the asset's continued use by the agency, as well as the costs of foregoing opportunities to use the sale proceeds for other things.

Nearly always, government's view of an asset's value will differ from that of a private user or investor because of its lower capital costs, tolerance for higher risks and lower returns over longer periods, and its pursuit of such public objectives as creating jobs or enhancing tax base. Other buyers or users have quite different aims.

Although simplistic, the criteria for disposing of an asset and the calculus to determine a fair price boil down to this:

Retain the asset when the benefits of its continued use exceed its market value as measured by appraisal or private sector offers. Divest when the benefits arrow moves in the other direction.

Although eliminating politics from government real estate decisions is like removing sand from a beach, when sound asset management principles are diligently and consistently applied by government agencies and elected officials alike, the inevitable conflict and controversy inherent in the political arena can be minimized for the public good.

As cities and states make news by selling assets or privatizing their management -- such as student loan portfolios and toll roads -- scripture and lore leap to mind. Public officials might daydream about the goose that keeps laying golden eggs, but also remember the Biblical Esau, who sold his birthright for almost nothing, and King Midas, who learned the hard way what it means when monetized assets are no longer there to hold.

Cautionary tales like these aren't slowing the pace of deals, many of which are driven by the pursuit of one-time cash infusions or the belief that the private sector can better control operating and maintenance costs. Chicago recently netted a whopping \$1.8 billion by leasing its 7.8-mile Skyway for 99 years while Indiana is leasing a 157-mile toll road for 75 years for a cool \$3.8 billion.

But as more jurisdictions take the plunge, they need policy-driven criteria and strategies for determining which properties to put on the block and how to get the most out of each.

Privatization is a popular, politically seductive label these days, but it has many meanings and profound long-term implications. When it comes to real estate, the public sector is often particularly unprepared to negotiate with the private sector and rarely has considered all the issues.

Will the newfound funds be used prudently? Citizens should be concerned when politicians, whose horizon may be limited by the next election, talk about disposing of assets for short-term budget relief rather than about the community's long-term needs. In Canada, revenues from offloading public property mainly go to renovating and repairing other capital investments.

Other tough questions should dog officials thinking about selling or leasing public goods. Might the asset be needed later? Should, for instance, old railroad corridors be sold when the next generation might have the needs and funds for more walkways or bike paths? Are current green spaces far from the madding crowd likely to be public oases amid sprawl in 20 years?

Questions like these can make long-term leases look better than outright sales, but not every asset appreciates over a century. Outdated water treatment plants, for instance, may cost more to demolish than they are worth.

Public officials need to follow the "first, do no harm" rule, making sure that the private-sector use is consistent with the community's values. Requiring a certain amount of open space with the sale of surplus land, for example, reduces the price obtainable from private buyers, but at least government won't find itself buying back some of the property later or fighting a protracted legal battle at taxpayers' expense. More generally, potential

partners need to be reliable and trustworthy -- good long-haul marriage partners, not just exciting dates.

Another question: how valuable is the asset really? For example, a city might not be able to do much with its tiny, scattered parcels of land, so a proposal to sell them may lead to more affordable housing, maintenance savings, and stronger neighborhoods.

Yet, however efficient, business can't be expected to magically cut costs, rehab or redevelop structures or sites, and wait for the user base to grow all at once. Metro Denver's E-470 toll road through a developing but still sparsely populated area, for instance, isn't the juicy investment that the only passable artery connecting Mexico's main cities might be.

Similarly, surplus land might need drainage tiles or a cleanup approved by the Environmental Protection Agency before business will take an interest. Or a public utility might need a bigger customer base or new fuel sources. Misunderstanding or misrepresenting an asset only wastes time and invites trouble.

The timing also has to be right. Whether jails, toll roads, transit systems, and the like attract private investors depends mightily on how much capital costs at the moment and on whether prospective investors looking at public assets can find sweeter deals in the private market.

Besides these general guidelines, governments eager to unload assets need to make some commonsense administrative moves. They need to accurately inventory what they own and keep the list up to date. They need to give agencies with expendable assets incentives to part with them -- perhaps a cut of the take.

And, if they don't employ experts on assets, they need to hire them rather than risk expensive mistakes and oversights. Even then, the policy and political ramifications shouldn't be underestimated. The donnybrook over the Indiana Toll Road demonstrates that resistance to change, labor fears, and a little patriotism can create a toxic stew for lawmakers.

As both the opportunities and temptations of unhanding government assets multiply, the wisdom of the ages comes in handy. But making the most of public property also requires clearly enunciated principles, administrative savvy, technical expertise, planning, and sound policy. Without all, good deals may turn out too good to be true

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