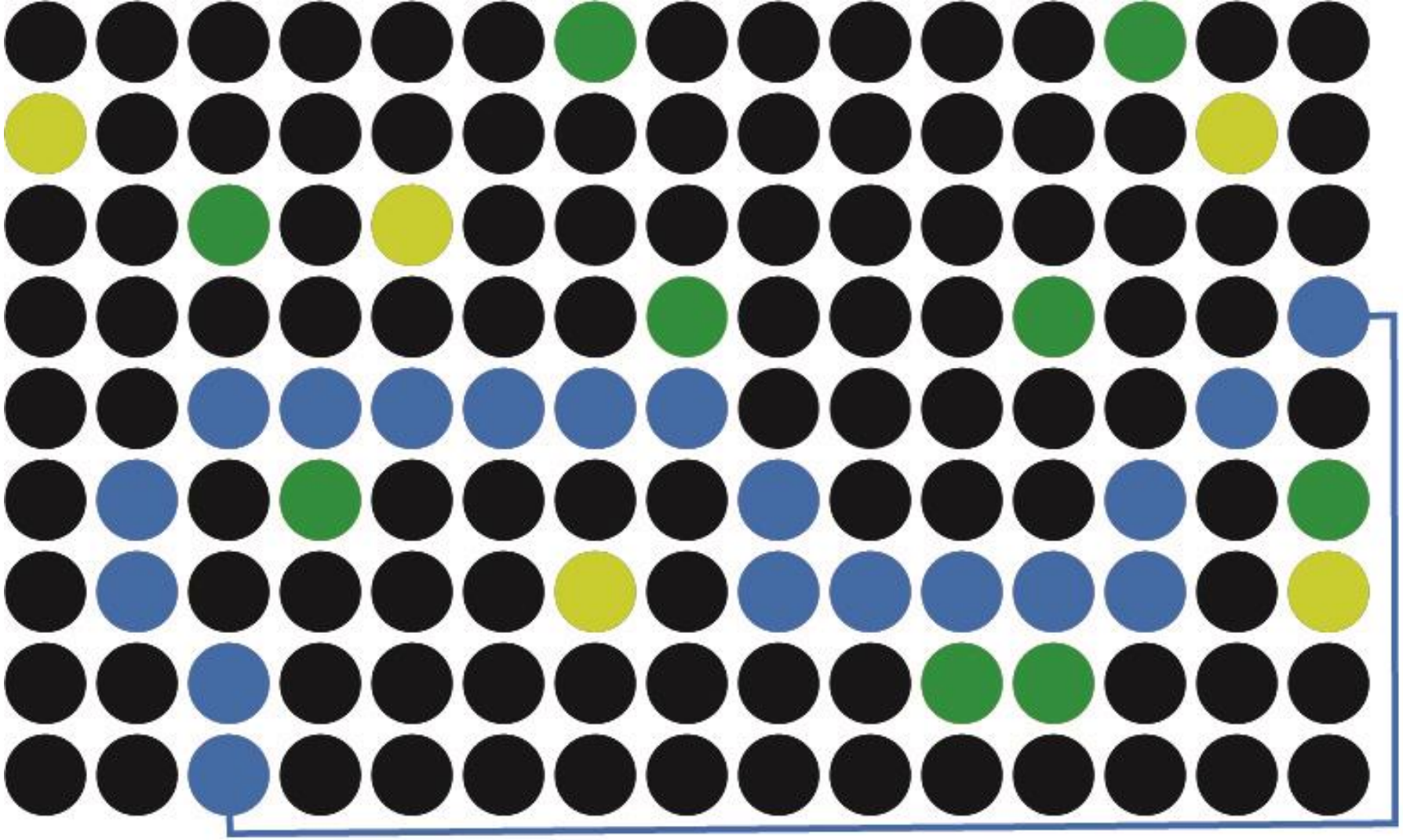


PUBLIC REAL ESTATE

portfolio management,
enhancing value,
improving performance.

Presented by: Gary Goliath

Why and how should we actively manage public property portfolios?

1. Background to WB activities
2. Theory: ‘Hidden’ wealth, urbanization and city mandates
3. Frameworks for applying Public Portfolio Management
4. Practice: Sarajevo (BiH)
5. Other considerations

Background

The clues and prompts to considering public portfolio management

- World Bank principally working on large, one-off, catalytic regeneration projects – consider moving upstream / take more systemic action
- There is a movement to improve portfolio management and mimic private sector portfolio management (mostly in advanced countries)
- Policy influences: IMF and subnational accounting, EU 'Green Deal', Public Building improvements for disaster mitigation
- WB has not historically worked in portfolio management – only 1990s as part of Municipal Fiscal Improvement programs
- There is no widely utilized framework/blueprint that can be relied on in different cities (differing legislative/regulatory dispensations, institutional organization, etc.) – so what is our intervention strategy?

Why worry about public portfolios?

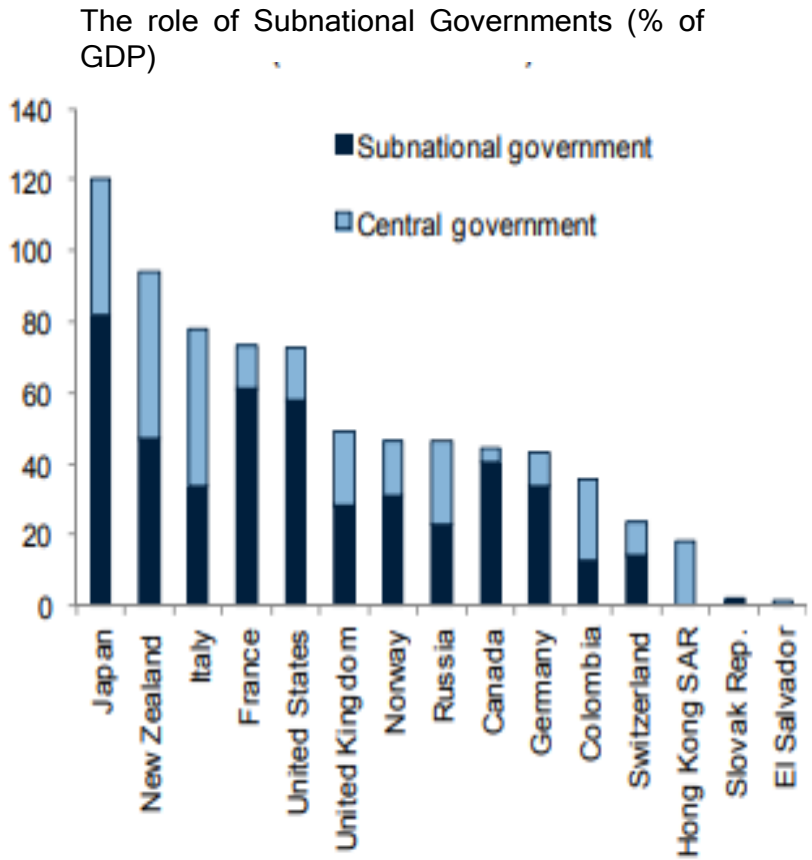
Cities have vast and growing funding needs

- Cities are worldwide economic engines for creating value for countries and their citizens, generating **82% of GDP.**
- Over next 15 years city populations will increase by **over 1 billion inhabitants** and **60%** of the 2030 global building stock is yet to be built.
- However, cities do not have enough funds to meet their growing needs for infrastructure, strategic financial goals, social programs, environmental tasks, among other projects.
- More than **US$65 trillion** will need to be invested in city infrastructure to meet the demand. Therefore, there is a need to increase revenues, decrease unnecessary expenses, and leverage all assets they have.

Source: Godfrey and Zhao, 2016

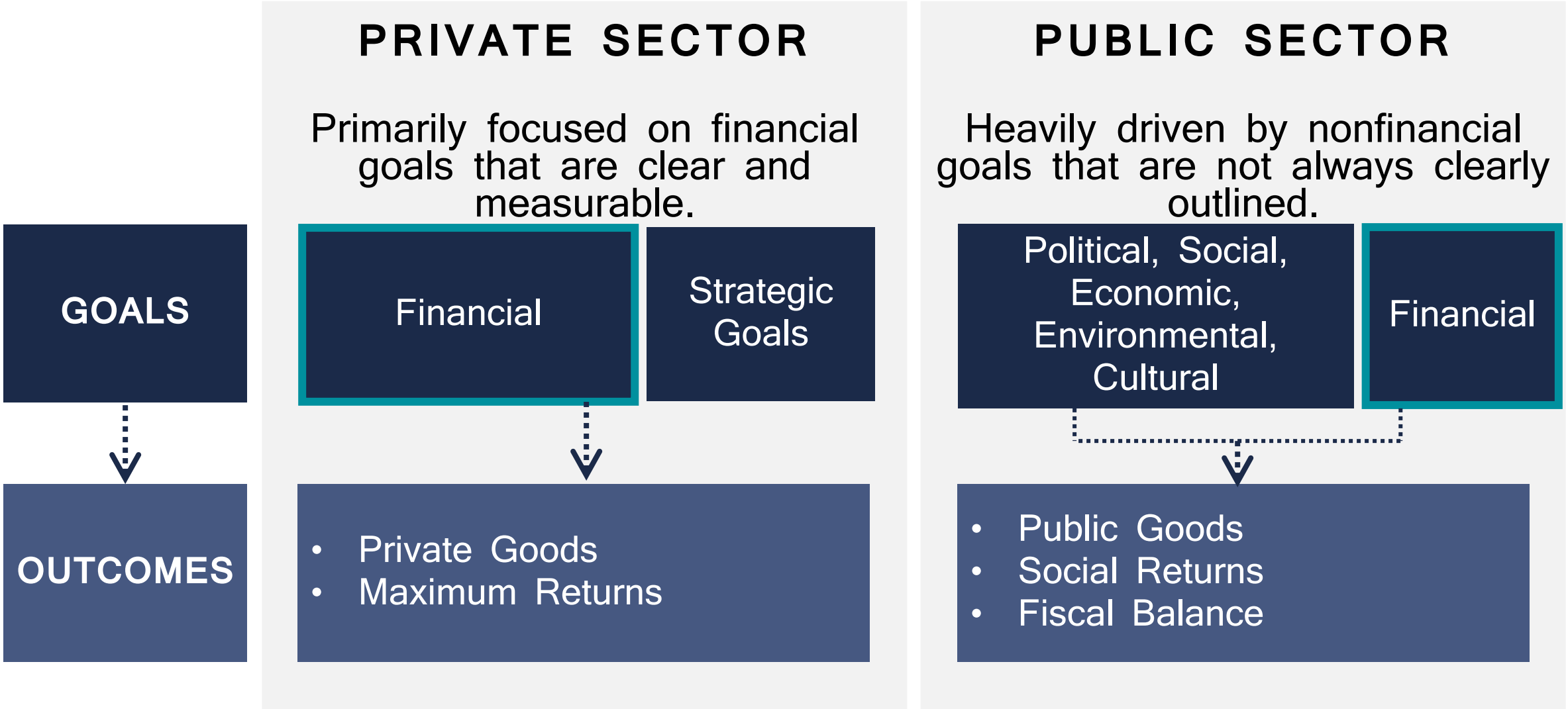
Cities have large, under-managed real estate portfolios

- The IMF estimates that **subnational governments control real assets valued at 25% of GDP**
  - non-financial assets (dominated by land, buildings and structures) are valued at about 50% of GDP, with subnational governments controlling about half.
- Advanced countries have seen a steady increase in the value of nonfinancial assets since the mid-1990s. By 2010, they accounted for over **80% of GDP** in France, Japan, Korea and Australia. In Hungary and Czechia, former transition economies, they are over 100%.
- Subnational governments in more advanced countries tend to have larger portfolios in comparison to less developed peers



Source: IMF 2013, Deloitte 2013, Finland Ministry of Finance, Unlocking Public Wealth 2018, Directorate General of State Asset Management, 2009

The goals of the public portfolio management can be centered around maximizing value or strategic utility.



Public real estate asset management allows cities to leverage real estate

Effective public real estate asset management entails:

1. Identifying and repositioning public real estate inventory to meet **public goals** and provide social returns
2. Implementing industry **best practices for operating** specific property types to maximize income, minimize costs and ensure proactive management
3. Establishing **annual budgets and targets** at both the asset and portfolio level based on needs of the city
4. Adjusting asset management plans and approaches based on **regular benchmarking** against financial and social metrics of overall portfolio and individual assets

Cities face measurable consequences of not actively managing their real estate portfolios

FISCAL CONSEQUENCES

High operating costs | Costs of building occupation are high due to excessive space utilization, utility costs, and high construction costs.

Example | Toronto's Public Buildings space rationalization is expected to yield C$30m per annum at program completion

Example | The City of Fredericton in Canada reduced annual expenditures by $6 million through an efficiency program.

SOCIAL CONSEQUENCES

Lack of resources for social programs| Tracking assets helps implement and fund social programs.

Example | In Madrid, after about 6,845 city properties, including subsidized apartments, were sold for €32 million less than the assessed value, they faced a loss in city finances and ability to serve those in need of affordable housing.

ENVIRONMENTAL CONSEQUENCES

Energy inefficiency| Buildings and building construction accounts for more than a third of energy consumption and quarter of GHG emissions worldwide.

Example | The City of San Francisco decreased its Energy Use Intensity by 15% between 2009 and 2018 in 500 municipal buildings.

SPATIAL CONSEQUENCES

Spatial Footprint| Poorly managed public real estate leads to sprawl. The result is higher transportation costs and less nimble housing markets.

Example | In Mexico INFONOVIT's support for housing on the periphery led cities' footprint increased 600% between 1980- 2010 and households spending 30% of their income on transportation.

Source: IMF 2013, Deloitte 2013, Finland Ministry of Finance 2020

Benefits of & challenges to public real estate asset management

A public real estate management strategy can achieve and should aim to maximize several benefits but also needs address common impediments to achieving the strategy

BENEFITS

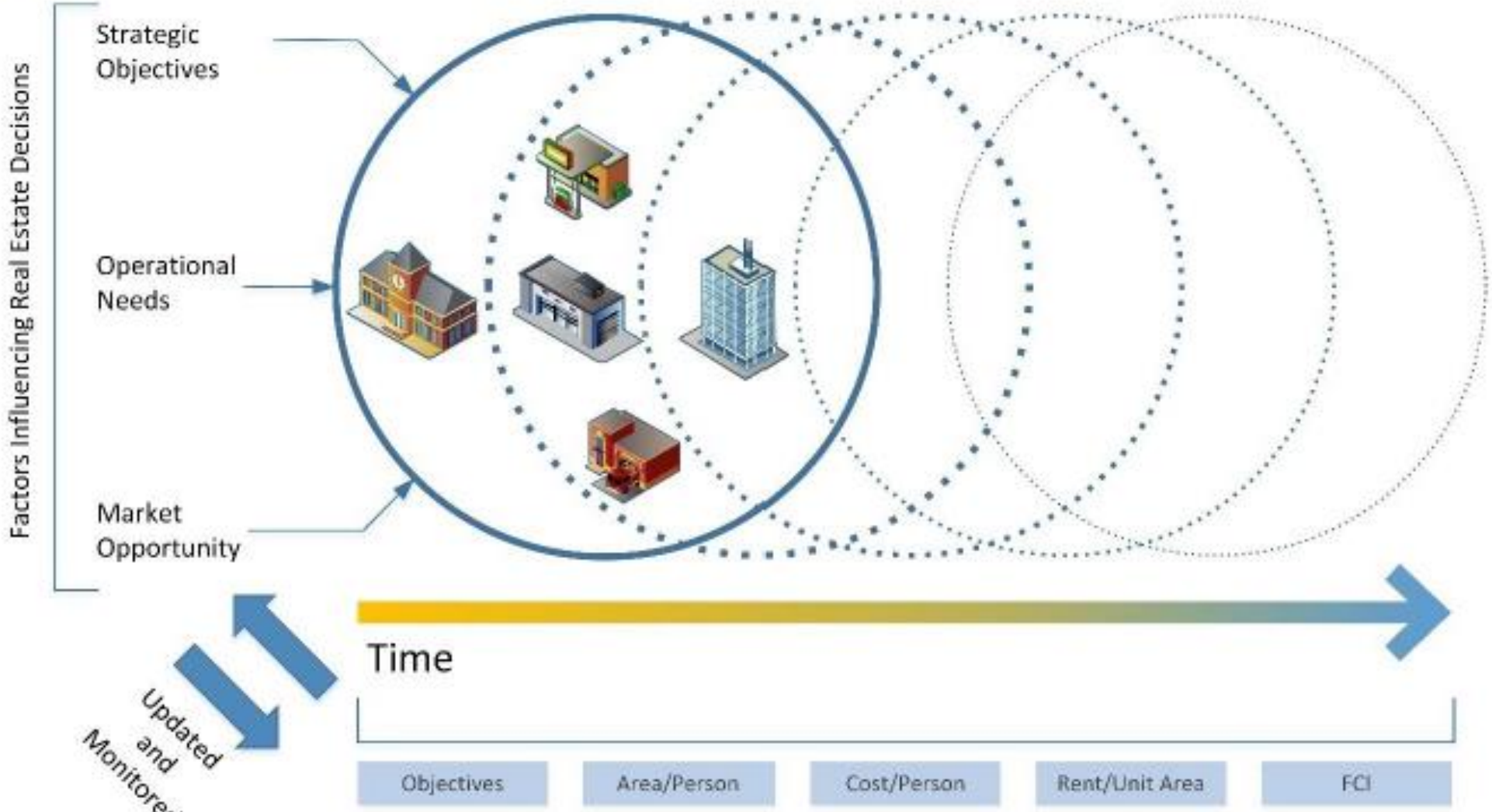
- Decrease Operating Costs
- Generate Additional Revenue
- Catalyze Redevelopment
- Finance Public Infrastructure
- Improve Resilience to Disasters

CHALLENGES

- Limited Technical Expertise
- Lack of Clear Regulations
- Lack of Internal Support
- Incomplete Inventory Data

What are useful intervention frameworks?

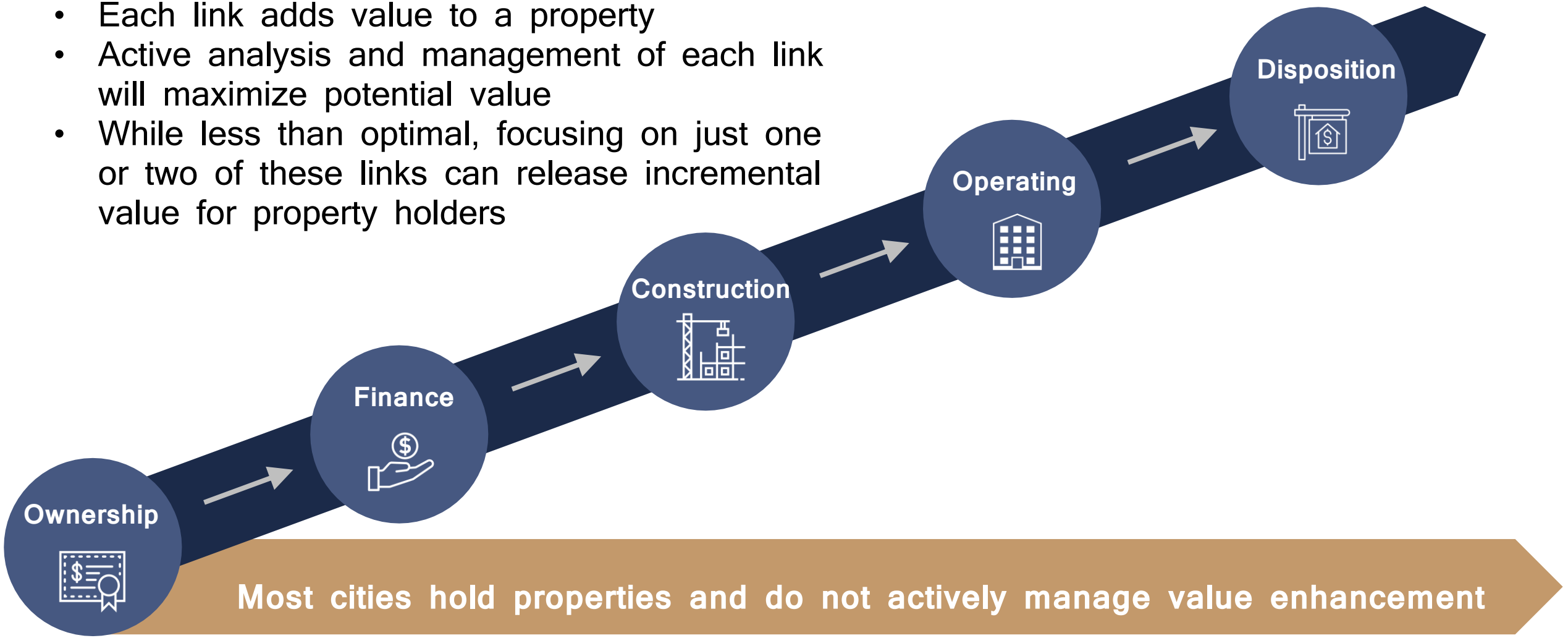
Conceptual Framework for Asset Management



Alignment with Strategic Objectives, Property Performance Metrics, Industry Benchmarks and Market Indicators are Monitored for Course Corrections and Adjustments

Creating and maintaining value through property life cycle

- Each link adds value to a property
- Active analysis and management of each link will maximize potential value
- While less than optimal, focusing on just one or two of these links can release incremental value for property holders

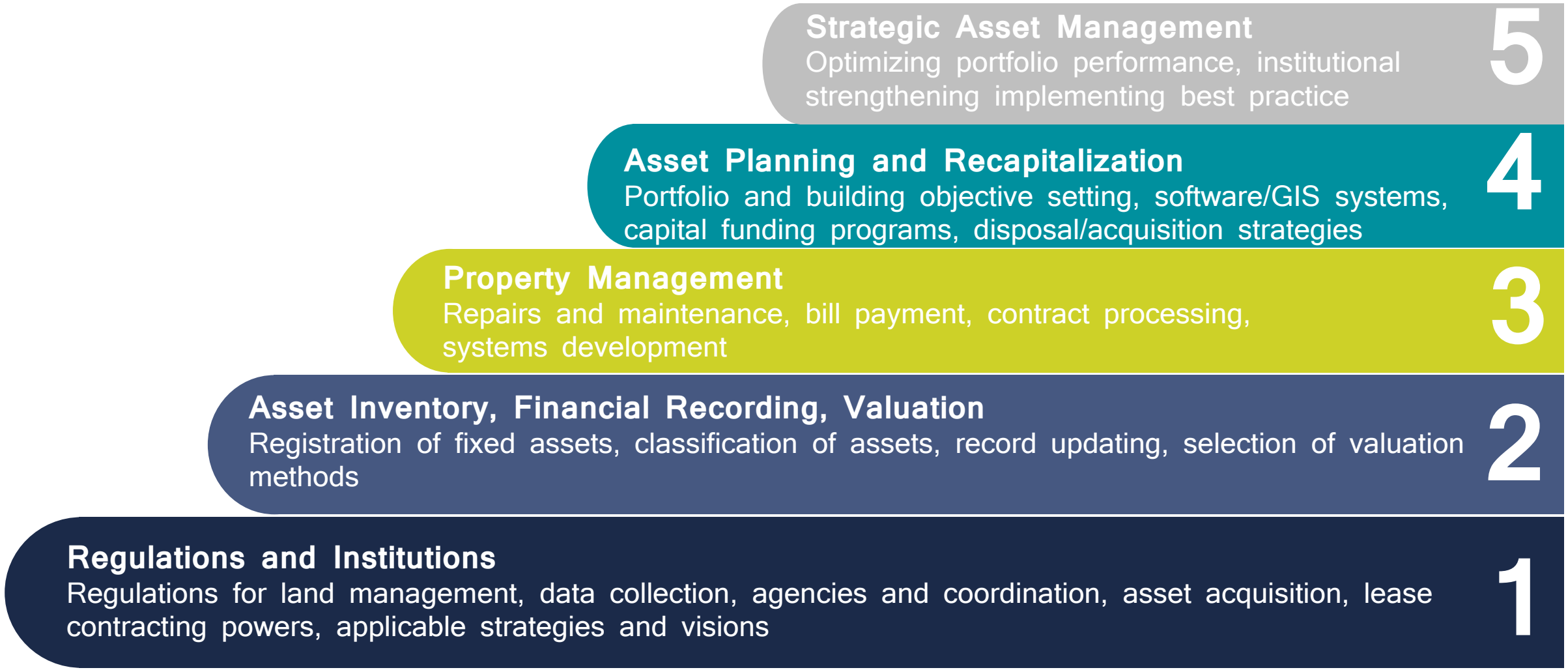


Asset intervention strategies

PHASES	EXAMPLE: BALTIMORE
1. Vision & Strategy	Raise property values through acquisition and redevelopment of vacant properties
2. Inventory	Created an inventory of 16,000 vacant properties
3. Value & Use Assessment	City assessed value and use of properties under city control
4. Action Plan	Targeted neighborhoods with local businesses or key institutions for property interventions including: renovation, demolition, and site infrastructure
5. Feasibility	Specific properties were identified through feasibility assessments
6. Implementation	The city implemented the program and expanded blight removal programs to support the initial asset management approach
7. Performance Monitoring	Updated metrics quarterly and since 2010 they have rehabbed 4,200 buildings and demolished 2,700 which reduced known vacancy by 43%. As of 2017, about $85 million of private investment has been leveraged in high vacancy areas, over $40 million more than what was received as of 2013.

Source: Vacants to Value, Urban Land Institute, Baltimore Housing

Multiple institutional building blocks are required for portfolio management

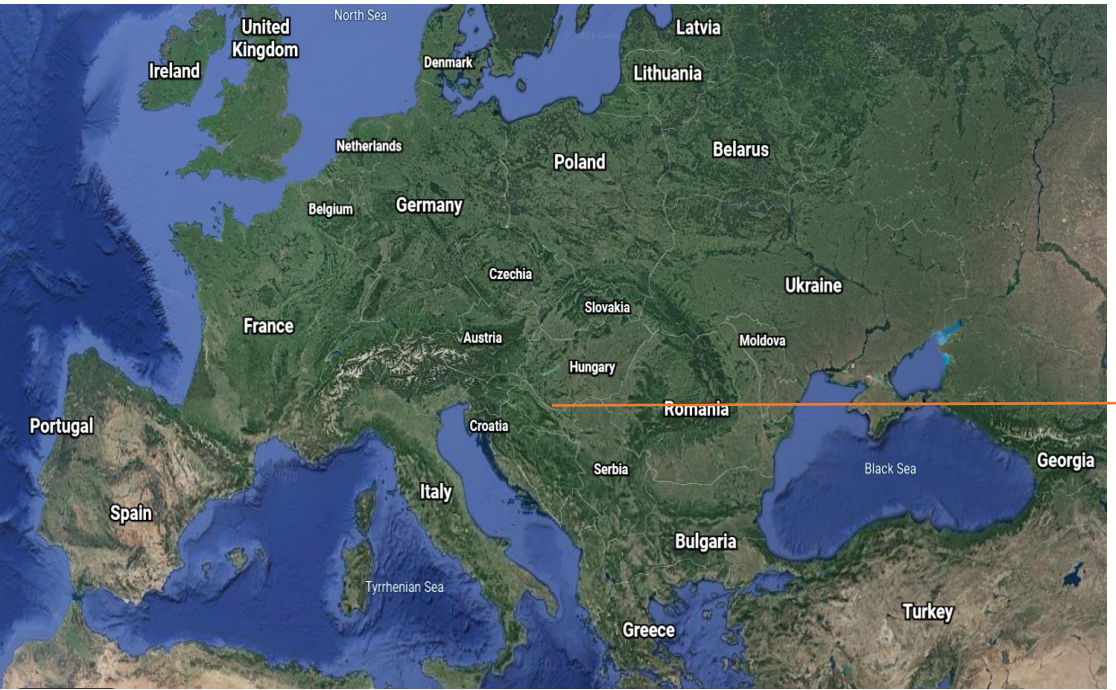


Applying theory to practice in Sarajevo

Canton of Sarajevo - Improving Real Estate Asset Management Project

Key objective: assess portfolio to determine cost reduction, revenue generation and value enhancing opportunities

- Capital of Bosnia and Herzegovina (pop. 3.3m in 2018)
- 450,000 residents over ± 1300 km²



Establish the current portfolio practices

- Who manages the portfolio?
- Who approves the ops budgets for properties?
- Who approves capital budgets?
- How are properties prioritized?
- Who manages the register of properties at Canton?

Diagnostic process

Identify Strategic Objectives

- Accelerate economic growth, increase employment, responsible environmental management

Property Database

- 254 (unverified and conflictual)
- Mostly residential but included multiple, large, strategic land parcels
- Education, health, utility departments

Derive 'representative' sample

- Size, location, potential use

Create dashboard of operational performance

- (1) Functional/Operational Metrics; (2) Relevant Market Metrics, (3) Decision Triggers
- Collected operational costs
- Prescribed tombstone data formats, and potential indicators and recommended thresholds

Identify opportunities (revenue generation, cost savings, redevelopment of prioritized sub-set of 20 properties

- Prioritized based on physical attributes (site area, location, etc); ability to provide social services; cultural and heritage preservation needs; commercialization

Findings & Recommendations

Data Findings:

- Operating expenses for educational institutions are similar to other Balkan cities (EUR/m^2)
- Administrative offices have expenses higher than the private sector
- Space allocated per person is comparable to private sector
- Space per learner is low

General Findings

1. There is a lack of clear title/ownership records for a substantial part of the Canton's portfolio.
   → Assign a dedicated team to compile and manage property asset registries.

2. The Canton lacks a unified approach to asset management, or a framework aimed at actively managing the functional or financial performance of its real estate assets.
   → Develop basic guidelines and objectives, required data, users, typologies
   → Collect basic performance data for inventoried properties
   → Review available software
   → Analyze priority properties

3. Disaster Risk mitigation policies do not include the role of real estate assets as pre- or post-disaster intervention
   → Develop criteria to measure DRM

Property Information	Input*	Remarks
UPIN	OFLRCBD0000001	Unique Property Identification Number
Property Name	CBD office Building	Registered official property name if any
Property Address	17 ABCD Road, Sarajevo, 7200B	Standardized address format
Neighborhood	Zone 1	Based on Canton's predefined neighborhood boundaries
Latitude	41.327953	
Longitude	19.819025	
Property Type	Developed Land	Developed Land, Vacant Land, Raw Land
Designated Primary Use	Office	Office, Residential, Retail etc.
Designated Zoning	CR2A	As per Municipal zoning bylaw
Site Area (sq. m.)	1,500	
Building Gross Area (sq. m.)	20,000	
Building Usable Area (sq. m.)	16,000	
Building Rentable Area (sq. m.)	18,600	
Construction Year	2000	
Design Life (Years)	50	

"Tombstone" data

(Should change much)

Property Functional Information	Input*
Current Use	Administrative
Occupancy (No. of Persons)	400
No. of Departments/Uses Collocated (No.)	3
Accessibility Compliance Rating	High
Access to Public Transit, Alternate Modes of Transport	High
Collaborative Space Design	Yes
LEED Rating	Silver
Occupied Usable Area (sq. m.)	13,763
Occupied Rentable Area (sq. m.)	16,000

Functional data

Operating data

Property Operating Information	Input*
Annual Operating Revenue (EUR)	4,800,000
Insurance (EUR)	-100,000
Repair & Maintenance (EUR)	-420,000
Utilities (EUR)	-500,000
Management (EUR)	-1,000,000
Annual Operating Expenses (EUR)	-2,020,000
Annual Property Tax (EUR)	0
Annual Net Operating Income (EUR)	2,780,000
Annual Capital Expenditure (EUR)	-300,000
Debt Service (EUR)	-1,000,000

Performance Metrics	Output*	Remarks
Property Vacancy (%)	14%	Ratio of vacant rentable area to total rentable area
Building Design Efficiency	80%	Ratio of usable area to gross area
Space Utilization Ratio	86%	Ratio of occupied usable area to total usable area
Utilization – Space/Person	34.41	Ratio of occupied usable area to total occupancy (no. of persons
Commercial Efficiency	93%	Ratio of gross area to rentable area
Colocation Factor	3	No. of departments or functions housed in the property
Annual Occupancy Cost	1,480,000	Net of all revenues, operating expenses, cap. Ex. And debt service
Annual Occupancy Cost/sq. m.	107.53	
Annual Occupancy Cost/person	3,700	
Estimated Remaining Life (Years)	30	It is a function of the asset's design life; sometimes it is adjusted to reflect the assets FCI
FCI	0.2%	Ratio of (deferred) repair and maintenance cost to replacement cost

*Outputs provided are indicative only

Proposed Metrics

Linking performance metrics to asset and portfolio decisions

Scenario	Inference	Decision Trigger
Space allocated per person for a property is higher than benchmark.	• Inefficient allocation of space. • Opportunity to rationalize space in accordance with best practices in the industry.	Initiate steps to optimize space utilization.
Annual occupancy cost per person and per unit area is greater than benchmarks.	• Energy efficiency of building services are inadequate; it is probably driving up utility costs. • Building condition could be poor, increasing annual repair and maintenance costs. • Potential overallocation of property management staff. • Opportunity to rationalize costs in accordance with best practices in the industry.	Initiate steps to optimize operating cost.
For a particular asset class: • Market demand to supply ratio and rental rate are higher than threshold/benchmarks and indicates an upward trend; and, • Market vacancy rate and cap. rate are lower than threshold/benchmarks and indicates a downward trend.	• Indicates consistent high demand and low supply for the near future. • Opportunity to (re)develop assets to address demand and maximise commercial value of existing asset.	Initiate steps to (re)develop asset.
For a particular asset class: • Market "demand to supply ratio" is lower than threshold/benchmarks; and, • Rental rate is static or falling, and shows a downward trend; and, market vacancy rate and cap. rate are higher than threshold/benchmarks, and, shows an upward trend; also, • Occupancy costs of new spaces in the market are comparable to the existing, and functional (qualitative) value is significantly high	• Indicates consistent low demand and high supply for the near future. • Opportunity to utilize newly built assets in the private sector through lease to address needs and add commercial value to the portfolio in the long term.	The private sector property could be acquired through lease.
If all things being same as d) and acquisition costs are lower than new construction/replacement costs.	• Indicates consistent low demand and high supply for the near future. • Significant functional and commercial value could be added to the portfolio if right properties for the organizations are acquired at the appropriate price point.	The private sector property could be acquired through purchase.

Considerations and challenges to public implementing public portfolio management

Other considerations

An accurate inventory of assets is the most critical building block irrespective of management structure

- Go through some verification process
  - Open source
  - Block chain
- Critical for governance and accounting
- National v provincial v municipal (integrated system?)
- Key balance sheet issue

How to look at the portfolio?

1 Transactional (surplus) v Core

- Literature is very clear: know what the purpose of property is – how does it link to objectives? This determines maintenance planning, capital investment, etc.
- But they are linked

2 Property v portfolio management

In general, you can make argument for a sum of the parts – but what about issues like co-location?

Objectives and Indicators

- Identifying key objectives upfront and have them filter down to properties
- Which indicators should we be using – depends on the sector/asset:
  - Education: space per learner norms – include fields, exclude fields?
  - Portfolio consideration: what are allowable adjacencies?
- There are different types of metrics – functional, market, decision triggers
- How to set data collection protocols when portfolio management occurs across departments?