GUIDEBOOK ON REAL PROPERTY ASSET MANAGEMENT FOR LOCAL GOVERNMENTS

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PREFACE

This guidebook builds upon several editions prepared for Croatia and Serbia, under technical assistance projects sponsored by the US Agency for International Development and implemented by the Urban Institute. In Croatia, this was Local Government Reform Project, and in Serbia - the Municipal Economic Growth Activity. This edition also reflects some issues that local governments face in Kosovo, Macedonia, Poland.

This guidebook is designed to assist local governments to make initial steps for improving management of municipal land and build-up property, within a good-governance and good-practice framework. While this version reflects some specifics of municipal land and asset management in Central and Eastern Europe, it contains main elements that can be useful for local governments elsewhere.
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I. INTRODUCTION

I.1. Objectives and the Content of the Guidebook

The primary purpose of the Asset Management Guidebook is to provide local governments with tools for increasing the utility derived from their property holdings. Real Property Asset Management (AM) is a very complex and multidisciplinary issue. Local governments in many countries do not use services of large networks of external experts, like property managers, appraisers, attorneys, and so on. The goal of this Guidebook is to suggest a systematic approach that government asset managers can implement on their own.

The Guidebook presents the principal reasons for the improvement of the management of real property assets owned by many governments and discusses the contents of typical real property portfolios. It also contains a set of recommendations for a systematic approach to effective real property asset management.

The model and methods presented in this Guidebook are based on international good practices, which were summarized and generalized by experts from the Urban Institute (UI) and then tested through projects in countries with former centrally-planned economies in Europe and Asia.

I.1.1. Practical Implication: Adjustment of Goals and Approaches to Local Reality

Throughout this guidebook, recommendations to improve Asset Management effectiveness are discussed. We encourage the reader to keep in mind the goals of strategic asset management, and to adapt these recommendations to the local situation as they think best. While there are general recommendations that can be useful to all asset managers, there is no precise formula, and success in asset management depends entirely upon the ability of the asset management team to make these recommendations work for them.

I.2. Notion and Terms

Asset Management - Historic Development

Asset management is a function that originated in the private sector and has evolved over time in free market economies. Initially, owners of income properties retained rent collectors who obtained rent from the tenants and delivered it to the owner. For this service, the rent collector received a commission of a percentage of the rent as compensation. Some rent collectors learned that they could improve the income to their clients (the property owners) by improving the property, working to reduce operating costs, and negotiating higher rents. They were the first property managers. Some property managers then learned that they could further improve the profits of their clients by thinking more broadly. They developed capital improvement plans to improve the productivity of the property, looked more openly at potential property usage, thought about the financial structure of the ownership of the property by using mortgage debt and perhaps limited partners as investors,

This section provides overview, while Annex 1 contains Glossary with more terms and notions.
and otherwise further improved the performance of their clients’ assets. They became asset managers. This evolution has taken many decades and is not easy.

Over the past 25 - 30 years, local governments in various countries began revising their approaches to managing portfolios of publicly owned properties and actively using the methods developed in the private sector. For example, many local governments in former centrally-planned economies are on various stages of the same process; in particular, as the owners of income properties, they are often in the “rent collector” stage and need to quickly move to the asset management stage to capture the potential income of their portfolios or gain other benefits for local governments.

**Real Property and Real Property Unit**

The central term throughout this document is real property unit. It is critically important to agree on the understanding of this term. For asset management purposes, the understanding is the same as in the real estate sector. Specifically, real property unit (in some countries – unit of immovable property) is defined as a separate unit in the State Cadastre or another state recording system, which is definitely recognized and delineated from adjacent properties and has a specific owner (in our case the local jurisdiction). As a physical, material object, a typical real property unit in most countries is a land plot together with everything permanently attached to it (buildings, structures, infrastructure improvements, trees, etc.). A real property unit may contain more than one building or structure (for example, a school is a property unit that may consist of a land site with a main school building and a separate sport facility building). Often, a local government real property unit consists of a part of a building, such as a part of the ground floor or basement in a multi-story building (the standard term for this kind of a real property unit is premises). A real property unit also may be a vacant land plot, without any structures.

Real property (without “unit”) is used as a generic term when the notion itself or some sets of real property units are discussed.

**Fixed Asset**

When a municipal real property unit is considered from the accounting point of view, it is a fixed asset, and as an asset, it is kept on the balance sheet of some entity. It has an owner, perhaps the City or some agency of the City (or other level of government). That owner has ultimate responsibility for the asset. It can delegate aspects of that responsibility for the asset to an agent but must hold that agent accountable for the performance of the asset.

**Asset Management vs. Real Property Management**

In contemporary real estate, asset management is defined as a process of decision-making and decision implementation regarding real property acquisition, use, and disposition. This process usually involves a group of real property units (named in this context real property portfolio) and may include redistribution of use and tenants among real property units in the portfolio.

A typical example of an asset management decision from municipal practice is as follows. A municipality owns two separate real property units partially occupied by municipal kindergartens, but each real property unit is only 50 percent occupied by the kindergarten; the municipality decides to combine the two kindergartens in one of the buildings and to sell the vacated building to the private sector.
I.2.1. Practical Implication: Alternative Asset Management Decisions

Do other alternatives exist? The solution of joining the two kindergartens may not be acceptable if the locations are widely separated and parents want their children nearby or cannot provide additional transportation. Here are some other possibilities:

- Lease excess space to commercial tenants
- Offer excess space to NGOs in exchange for vacating other space which can be leased to commercial tenants.
- Convert excess space to homes for elderly citizens who can assist in the kindergarten.

Can you think of other options or choices?

Real **property management** deals with daily operations and maintenance of a separate real property unit. Typical real property management tasks include arranging for cleaning, maintenance, small repair, landscaping on the site, and provision of security. For rental (investment) real property units, real **property managers** are usually responsible for working with tenants as well: finding tenants, signing lease agreements, providing agreed services to them, and collecting rent. In western practice, the property manager does not directly provide the cleaning, maintenance, and similar services but instead seeks bids from independent contractors that specialize in such work. The bidder offering the best price for service at a specified level of quality is awarded the contract to provide such service. The contract can be terminated at any time for failure to perform as agreed. The term of the contract is limited to perhaps a year so that the service provider is motivated to perform well to improve the likelihood of having the contract extended. For the portfolio, this competitive process produces the best quality of service for the lowest cost.

It is important that **management** be distinguished from **maintenance and repair**. Management is the process of assuring that a property is operated for optimum short-term and long-term performance including cash flow and the enhancement of value. **Management** is not painting, replacing broken windows, and repairing the leaking roof. If the property manager also performs those maintenance functions, the owner can rightly question whether the manager is doing the best possible job at the lowest cost or is simply seeking to obtain additional revenue.
I.3. Background - Asset Management in Countries with Former Centrally-Planned Economies

Local governments in such countries often control substantial amounts of real property of very diverse types. Therefore, there are many opportunities to improve the management of local government's real property assets.

Major characteristics of the typical property situation are as follows:

- Cities control many large real property portfolios
- Management of some portfolios is split among several entities
- In some cities, municipally-owned premises constitute a big (sometimes dominating) part of business rentals
- In some cities, use of city’s business premises is over-regulated, by Western standards
- Rental revenues are an important part of own-source local revenues, but net rental income is not known
- Cities provide indirect subsidies to tenants of city’s properties through below-market rent, and not always estimate or monitor these subsidies
- Inventory of municipally-owned (or controlled) land does not exist or is incomplete
- There are no mid- or long-term plans for offering municipal land on the market
- Management of many portfolios is conducted by enterprises and enterprise-type entities
- Performance / profitability of municipal enterprises and properties vary by city, and even such potential “cash cows” as markets are not always produce revenues to cities.
In some countries, transitional processes of devolution, restitution, and privatization cause rapid and massive changes in the content and size of portfolios in some municipalities.

Asset management requires accurate data at the property level. Decisions regarding sale or retention, expenditure of capital funds for major renovations, rental rates, and financing options require valid information. Incomplete financial information at the property level, absence of market data (regarding competitive rental rates and sale values), and expense data not fully segregated by property will hinder effective asset management and will result in the failure of the portfolio to meet the financial and social needs and expectations of local people to whom the property belong.

I.3.1. Practical Implication: Example of Incomplete Financial Data in Serbian Municipalities

Total property related local budget revenues, including property tax, “land development fee”, land use fee, and land lease, in nine surveyed municipalities varied in 2005 from 7.3 percent (Prokuplje) to 26.4 percent (Indija) of gross local government revenues. However, real property causes recurrent expenses and capital expenditures as well, and until the net financial results are known, local governments have no ground to judge whether real property – even a revenue-generating one – creates a net financial inflow or drain. The need to have a complete picture of how real property assets influence the financial standing of the local government is one of the key reasons for introducing contemporary asset management.

Presence of large number of properties or premises that are not needed for local government operations and are used as rental property creates both opportunities and threats for the local governments. On one hand, there are opportunities for improving the local financial standing and service delivery and facilitating local economic development. On the other hand, there is also a significant risks that:

1. The attention of the local government will be diverted away from providing core services, with its attention to management of its large asset portfolio;

2. Some local governments would dominate the rental market, which could lead to market distortion and unfair competition with the private sector; and

3. Local government will be exposed to either real or perceived corruption and the related loss of confidence in the local officials responsible for the portfolio.

There are also different views on whether local governments should be involved in property-related commercial activities. Officials may seek to use property for providing a needed service to the public or earning profits to fund the local budget. However, public employees may lack the expertise and competitive motivation to be successful and efficient in property-related businesses, and may compete unfairly with private enterprise.
I.4. Asset Management Model

A well-developed local government real property asset management model should help local governments clarify and define the contents of their real property portfolios, as well as to monitor and control their functional and financial performance. Local governments will be able to manage their property assets effectively and efficiently only if they adopt key elements of private sector asset management practices:

- site based management, accounting, budgeting, and operations
- relevant and regularly updated databases on physical, operational and financial characteristics of properties
- annual reviews and reporting
- private market benchmarks, including market value of all alienable properties
- financial tools and performance standards used in the real estate market (such as return on investment and capitalization rate calculations)
- introduction of effective competition to leasing, sales, and sourcing of services and materials
- culling of smaller properties through sale to improve portfolio management efficiency

The application of these practices can be combined into five principal areas on the part of the local government:

- **Classify properties according to their relation to local government functions.** Financial policy, responsibilities, and the “hold or dispose” decision of the local government regarding each particular property should depend substantially on why the property is needed and how it is used. Whether a building is used for a **core function** such as housing the city government itself, or for a **social function** like showing movies, will influence further asset management approaches and decisions.

- **Build a property database.** The asset management process is dependent on accurate and thorough data. Some of this data, such as addresses and physical characteristics, will rarely change. Other data, such as financial performance and occupancy, will change constantly.
• **Create a department dedicated to asset management.** Responsibility should be centralized so that a department and individual officials in that department are accountable for the results of the asset management process.

• **Formulate a strategic role for real estate in attaining municipal goals.** This is a process that must be conducted at the local level with thorough debate and consensus. Goals may include providing mandatory services as efficiently as possible, generating revenue to fund local government functions, improving the cultural life of the city, improving the physical appearance of the city, or reducing the subsidies to non-government organizations and social users of assets. Other goals may be identified as well.

• **Implement portfolio management practices.** Once goals have been established and an organization is formed, asset management practices must be implemented. Asset managers must focus broadly on achieving the goals set forth by monitoring daily and monthly asset performance and by planning and executing long-term strategies. It is very important that the asset management department establish objectives, plans to achieve those objectives, and monitor progress toward such achievement.

The asset management model proposed in this guidebook consists of the following activities (a detailed description of each activity can be found in section II of the guidebook):

1. Designation of an intermediate body that will lead on asset management improvements during the initial stage

2. Introduction of a database/inventory system for individual real property units

3. Property classification

4. Improving relationship between local governments and their public enterprises and providing basis for better public services delivery

5. Property-Related Public-Private Partnerships (PPPs)

6. Improving land management

7. Real estate and business appraisals

8. Property accounting and financial planning (operating statements for properties or portfolios)

9. Intensive financial analysis of portfolios, properties, and investment projects

10. Deregulation of business rentals and improvement of rental practices

11. Quantifying and monitoring direct and indirect property-related subsidies obtained by tenants and users of local government real estate

12. Reporting on property

13. Management Consolidation

14. Developing a Comprehensive Asset Management Plan
II. ACTIVITIES FOR EFFECTIVE ASSET MANAGEMENT

II.1. Activity 1: Designation of an intermediate body that will lead on asset management improvements during the initial stage

International experiences show that organizational changes needed as a part of asset management improvements do not happen quickly, and in any event they should be well thought through and prepared. In interim, somebody should spearhead and coordinate various efforts and activities at initial stages, and especially because asset management functions usually are fragmented and performed by many departments and municipal enterprises. This can be a special Task Force or Work Group, but it should have a sufficiently high status for making things happen. This Task Force (TF) should be established formally, by a special resolution of a mayor. Its initial mandate can be for 18 months, after which further decision will be made.

The TF may include the following members:

From the municipal side:
1. Mayor
2. Municipal Secretary or lead municipal lawyer
3. Head of Financial Department
4. Head of Urban Planning Department
5. Members of City Council (two)
6. Heads of departments and directors of municipal enterprises that control main property portfolios
7. Appointed staff members from these departments and enterprises for technical work as needed
8. Head of municipal IT department and IT experts as needed

From the private sector (Advisory Board for the TF):
- Real Estate broker
- Land development lawyer
- Member of the local chamber of commerce

One of the TF members should become its Chairman, with the following responsibilities: Liaisons with the most important outside counterparts; leads on presenting TF recommendations and results to the City Council; secures that TF works according to the schedule and its recommendations are implemented.

The TF also needs a Coordinator / Facilitator, with the following responsibilities: Keeps TF activities according to the schedule on track and on time; assigns specific tasks to various members of the TF.

The TF works according to its schedule. It meets regularly (once each 2-4 weeks).

The TF may establish internal teams (with extra assistance if needed), for dealing with specific tasks; for example:
The Inventory Team
The Financial Management & Reporting Team
The Strategic Land Management Team

II.2. Activity 2: Introduction of a new Database/Inventory System for Individual Real Property Units

Recommendations for implementation:

- Begin data collection according to Appendix 2, “Local Government Asset Inventory Guide”
- Start from the best and worst performing properties and portfolios. It is likely that this will be the portfolio of business rental properties, followed by other portfolios (such as rental apartments, for governmental use, sport facilities, etc.)
- Include a special section on real properties which cities do not control but support financially (such as primary schools, kindergartens, and health centers)
- Either develop or adopt an existing computerized database for maintaining this information

The purpose of this chapter is to assist local governments in collecting basic data on municipal real property that is necessary for prudent asset management.

There are some common arguments against this type of data collection effort. First, to compile a complete and accurate inventory requires a significant amount of time, which places an additional burden on limited local government resources. There is also debate on which properties absolutely require inventory, and which (though inarguably local government property) do not. This includes parks and streets. Finally, some may argue that if the public need is being met by the current system, the system must be sufficient as is.

However, creation of an accurate database and inventory of local government assets is a crucial first step in establishing an effective asset management system. The institutionalization of a thorough database will allow the local government to monitor and analyze real property assets and portfolios, and to develop and implement a strategic plan for managing various types of municipal assets. Additional factors that support inventorying include:

- Responsible stewardship of public assets requires data collection and monitoring
- In some cases, a legal obligation to collect data
- As a precondition for municipal bond issues
- Improves local government accountability and transparency in property dealings.

In short, an accurate inventory is necessary for effective asset management. Improved asset management, by intensifying property use, reducing property related spending and increasing revenues, will offset the initial costs of creating the inventory.
The inventory should include two separate types of information. First, there must be an actual inventory of assets, which eventually should be entered in a map-related database, so that current maps of municipal property would become available to local government and the public. Second, the inventory must include tenants, financial and accounting data. The information should be collected on an entire real property, not on separate premises within the real property.

Appendix 2 contains a sample inventory format. Collecting all the data needed for good asset management takes time and effort: for example, in Annex 2, Table 1 alone has 18 positions. Usually, all the data is not available at once, and practical questions are (i) from which positions (columns) to start and (ii) whether some positions should have priority. There are no universal answers, because information reasonably available varies by municipality, and priorities of data collection depend on immediate uses of this data. For example, one municipality may be interested to assess how much funding they need for repairing their properties and, therefore the column on building conditions will be on their high priority list. Another municipality may be interested to identify space not used for their functions, and for them the level of use of property units would have higher priority. Nevertheless, an obvious and universal priority is information that would allow easily locate each property: in the ideal case, this should include both address and cadastre data. But at least one of this – the address or complete cadastre data should be included from the very beginning. Another useful view on prioritizing inventory efforts is to decide which types of properties (“portfolios” discussed in the next chapter) have the highest under-utilized value for the municipality and which ones are at the highest risk of being alienated without direct benefits to the municipality – and start inventorying from them. From this viewpoint, vacant construction land and land used by municipal enterprises should be high on the priority list (for more detail, see chapter II.7).

A big issue is an information technology platform for inventorying. Eventually, this should be a database on municipal property and it should be GIS-related. However, as experiences of municipalities in many countries to date have demonstrated, developing a viable GIS and related database on municipal property is a task in itself, which should be well planned and takes time to implement. Therefore, the recommendation is to start data collection even if a database and GIS are not ready yet for use. As a temporary solution, the data can be collected in Excel charts, with the data later migrated into a real database.

II.2.1. Practical Implication: Inventory Problems

In implementing this model, two types of inventory problems can be identified. First, databases are incomplete and inaccurate. This problem is serious and requires a long term, disciplined and organized process of database creation and maintenance. Second, separate departments within local government may have good property records, but there is no central location or body that consolidates this information. This issue could easily be addressed by creating a single database that could be accessed by all departments and by establishing appropriate communication channels to exchange information.

Currently, most local governments do not track some categories of data on a property-by-property level. Especially complicated is the situation with expenses and revenues. In particular, expenses cannot always be identified for each real property unit, mostly because the traditional accounting and budgeting practice of local governments has not been oriented toward this task. For example, it is quite common that entities within or even outside the local government (such as social tenants, cultural and sport institutions) receive lump sum funds from the local budget to cover various components of operating and maintenance costs for

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2 This Guide does not deal with the issues of municipal asset management databases and GIS.
various groups of properties. As a result, operating and maintenance expenses for a particular property may be paid by more than one entity; at the same time, some of these paying entities do not track the specific property units on which they spent these funds. On the revenue side, there are cases when social tenants (for example, sport clubs using local stadiums and arenas) generate revenues at the property while the owner has no data on this revenue and continues to subsidize the clubs by providing funds for stadium maintenance. In many instances, property-based revenue data can be extracted, but it requires a lot of effort.3

It is important that the owner of the asset track the total revenues and expenses associated with each property, even if they do not go in or from owner’s funds. For example, municipal enterprises often manage rental properties on behalf of local governments, and retain revenues in lieu to payments from the government for other services. In such a case, the government has to have reliable information on these revenues retained by the managing enterprise.

For some types of rental properties, it is customary for the tenant to pay all expenses and also pay a net rent to the owner; in this case, it is less important for the owner to have all property expense data. The owner must be assured that taxes and insurance costs are paid and that the property is well-maintained, but the actual expenses for such work are not recorded by the owner.

It is also important to track the difference between the needed recurrent expenses and actual expenses (this difference has to be tracked on an annual basis). If the actual operational and maintenance expenses turn out to be lower than the need, and such under-investments accumulate, that could result in early dilapidation and deterioration of the property. The knowledge of the accumulated deferred maintenance is very important for an understanding of the general situation with municipal property. A successful asset management approach provides for maintaining each property at a high quality so that value accumulated in real estate does not decline. For rental properties, this helps attract prospective tenants and improves the possibility of quickly leasing the property at a favorable rental rate to the benefit of the owner. Repairs and replacements should be made with a focus on life cycle cost rather than initial cost. However, if monitoring of deferred maintenance indicates that it is accumulating, asset managers should recognize that this unavoidably leads to declining property values. This should be avoided to the maximum extent possible. Building up deferred maintenance should stimulate some radical decisions, such as disposal of properties that the local government can not properly maintain, reducing property-related subsidies to tenants, revising local budget priorities, and so on.

3 The fact that current budget and accounting practices are insufficient for managing large local government property portfolios emphasizes the importance of clarifying the roles of asset and property managers.
An important part of the asset manager’s job is regular property inspections to monitor maintenance. While underinvestment may be indicated by financial information, the true test is a physical inspection of the property. The inspection must focus on elements subject to change since the previous inspection, such as the roof and mechanical systems. As with other aspects of asset management, critical thinking is important so that maintenance is driven by practical need rather than irrelevant formulae.

The principal question that local governments may ask is this: What is all this detailed information needed for? As the discussion above indicates, the simple and very general answers are:

- Analysis of whether expenses are necessary and rational.
- Maximizing net rental income and cash flow over the long term.
- Identifying specific properties or groups of properties that are not producing strong financial results, and identifying corrective interventions.

An important practical question for many local governments is where to start implementing the new system of data collection and maintenance. Though most local governments have a variety of portfolios, larger income-generating (rental) properties appear to be the most rational starting point.4

Another critically important portfolio that should be cataloged and mapped as a high priority is vacant construction land (both “public” and “private”).

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4 Technical issues of the database are not explicitly discussed in this guidebook. The guidebook also does not cover municipal movable property, such as automobiles. Ideally, the data collected in accordance with the suggestions above will eventually form only one component of a larger local government property inventory (of both moveable and immovable property).
II.2.3. Practical Implication: Inventory Issues

The process of preparing an inventory can be an intimidating task, especially given the amount of data to be collected for each property, the number of properties, and the lack of a centralized source of information. Those people responsible for this assignment are already busy with their existing workload, and this is just one more task.

The simple act of assembling this information would probably lead to important discoveries, including the current underutilization of certain assets, assets that generate very low cash flows, allocation of prime space to NGOs paying little or no rent and rarely using the space, shortage of vacant land, and other circumstances that offer early and relatively easy opportunities for improving the financial performance of the portfolio or a more strategic view at municipal land.

The key to success is to make the commitment to inventorizing assets, and to seek progress, not perfection.

II.2.4. Regional experiences, Croatia: Inventory of municipal assets

In the City of Split several major changes occurred:

- The new geographic information system (GIS) was developed
- The official land record increased from zero to 12,500 units, which were added to the new GIS
- The land value of only the unused construction land is estimated as $360 million.

In the City of Karlovac, a comprehensive asset inventory developed as a part of asset management model resulted in the number of units in the common registry increasing threefold. An unexpected result of creating asset inventories was that cities started to intensively address unresolved ownership issues.

Things to think about:

In your community, which specific portfolios would you identify and why?

What data do you need for each real property unit in each portfolio?

Where will you find this data?

How can you most efficiently collect and record this data?

What do you expect to learn from the simple act of collecting this information?

II.3. Activity 3: Property Classification

Recommendations for implementation:
Draft classification of all properties into three groups: mandatory, discretionary, and income generating (surplus)

Formulate financial principles and goals for each group of property

Introduce standards for “property consumption” for those entities receiving support from the local government

Approve the classification and financial principles/goals at the Local Council\(^5\) as a part of the Comprehensive Asset Management Plan

**Typical contents of real property portfolios**

Property portfolios of local governments are usually diverse and may include many of the following components:

- Land: municipally-owned land of all types (for public use as roads and parks, built-up land, vacant land for construction, agricultural, etc.)
- Residential (social apartments, non-social apartments, other)
- Office buildings and premises for governmental and semi-governmental use
- Non-residential (business) rentals
- Sport facilities (stadiums, football fields, tennis courts, swimming pools, etc.)
- Kindergartens
- Primary schools
- Health centers
- Cultural facilities (museums, libraries, theaters, movie theaters, other)
- Farmer markets
- Parking lots, on-street parking places, and parking garages
- Industrial and warehouse/distribution real estate
- Local public enterprises and their property assets: utility enterprises (gas supply, water, sewerage), core urban service enterprises (cemeteries, landscaping, cleaning), business enterprises, other
- Other property

**Property classification: mandatory, discretionary, and income generating (surplus) properties**

Before discussing property classification, it is important to review some basic ideas. The roles of local government as real property owner can be grouped into traditional and non-traditional categories. The traditional role of government includes supplying the correct quantity of property for public goods and services at the lowest cost, compared with alternative feasible arrangements including private sector provision. The non-traditional role of government includes supporting local economic development and obtaining governmental revenues from alternative sources. Although the understanding of traditional and non-traditional roles might be reversed in some countries, it is still important to bear in mind this distinction while classifying properties.

In the private sector, the goal of property owners is typically to maximize value. Returns on investment are optimized in relation to risks (political, economic and transaction risks). The

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\(^5\) “Local Council” is the term used here for a local elected legislative body.
general trend in developed countries is for local governments to adopt many concepts and methods of property asset management used by the private sector.

As mentioned above, local governments can be responsible for a wide range of functions. To accomplish these functions successfully, local governments must adjust their property philosophies to align with three global trends in the property sector:

1. Transform from being a direct provider of real estate to an enablers of the private sector to supply real estate;
2. Cease treating real properties as public goods and consider them instead as productive resources; and
3. Adopt efficiency-oriented management practices developed and tested by the private sector.

Local government functions now include management of settlements and housing, physical and urban planning, communal services, economic development, child care, social welfare culture, physical culture and sports, environmental protection, then partially primary health care and primary education. According to these functions, properties controlled by local governments should be sorted in three groups:

1. **Mandatory** – properties needed for performing the functions that are the responsibility of local government, as stipulated by law,
2. **Discretionary** - properties needed for performing the functions that are voluntarily supported and performed for social, political or other reasons, and
3. **Surplus or income generating** – properties not needed for any of the first two groups.

Further, local government needs to decide on standards for "property consumption" for those institutions and enterprises that receive support from the local government. Legislation clearly defines some functions as exclusively or shared responsibilities of local governments, and accordingly, also defines mandatory local government facilities. These facilities include water/sewer infrastructure, cemeteries, sport facilities, kindergartens, primary schools, theaters, museums, libraries, parks, social housing, and some others. However, a key issue that is not addressed by law is how many facilities the local government is required to support. The local government has discretion in making related decisions and introducing some standards of “property consumption” that the local government supports from its budget. For example, should it support all sports facilities at its territory? This is a particularly important opportunity for the local governments to set standards in accordance with the willingness and ability of their populations to pay for these services.

**Formulate financial principles and goals for each group of property**

Use of properties for mandatory functions should be optimized by:

1. Increasing the efficient use of facilities, by requiring governmental departments to justify demand for their space
2. Minimizing operating costs
3. Locating government offices and services in functional, not prime areas, and in modest buildings and facilities
4. Understanding the best use of an asset and making cost-benefit analyses to justify the governmental use of particular properties.
Assets for discretionary functions should be optimized by:

1. Analyzing actual costs in order to facilitate the best decisions
2. Generating program alternatives to reduce direct and indirect property-related subsidies as much as possible (also see Activity 12); particular suggestions include:
   - Have users or their sponsors maintain the property themselves,
   - Encourage users or sponsors to lease unused portions of premises or territory to other commercial or non-profit entities, accurately account to owner for resulting net revenues, and adjust subsidies appropriately,
   - Establish clear contractual relations with the users, which stipulate mutual responsibilities for property maintenance and allocation of the costs and revenues,
   - Monitor usage and occupancy to assure that unused space is reassigned to more serious users,
   - Arrange sharing of facilities by multiple groups.

Local governments may have excessive properties intended to support a mandatory function. For example, city offices may not occupy all of the space available in buildings owned by the city for that purpose, or the space may be occupied inefficiently and unnecessarily. Consequently, the excess space may be classified as discretionary or surplus.

Surplus property is not needed for the core or discretionary functions, but it serves as a source of revenues for the local government. Optimization occurs by:

1. Leasing property at its highest and best use, to generate recurrent net revenues (profit);
2. Periodically evaluating income-generating performance of these properties using alternative investment benchmarks;
3. Making selective capital improvements to enhance income production;
4. Selling under-performing properties to generate one-time revenues that can be put to better use (when Law on Property Devolution is approved); and
5. Reducing maintenance costs and liability on the property if it cannot be leased or sold.
Approve the classification and financial principles/goals at the Local Council

According to the current regulatory framework, it is not necessary to present the classification and subsequent real property management decisions to the local council for approval. However, because this issue is strategically very important and will have both short and long term effects on the population, it is recommended to have both the buy in and approval of the local council before any decisions are made.

It is also recommended to publicize the importance of effective real property asset management among stakeholders and upper-level local government officials. This is particularly true for applying appropriate asset management methodology and techniques and in the decision making process at the highest political level of the local governments.

II.3.2. Regional experiences, Croatia: Classification of assets

Local governments held very different portfolios of assets, from two-thirds of assets classified as discretionary (cultural, sports, educational or social), to two-thirds of assets classified as surplus/profit-making. Through rationalization of portfolios, functional and fiscal improvements were achieved.

Things to think about:

What local services and functions are required by state law and regulations?

Which properties are needed for them?

Which properties are surplus, in your opinion?

The classification of which particular properties do you expect to generate debate and why?

II.4. Activity 4: Improving relationship between local governments and their public enterprises and providing basis for better public services delivery
Recommendations for implementation:

- Re-shape the relationship between local governments and their public enterprises: improve oversight of the enterprises on one hand and give them more operation and management independence, on the other
- Improve business practices of municipal enterprises
- Introduce contractual relations with municipal enterprises
- Place some services on open competition

Context

Having some control over local service companies – where they exist – seems to be an imperative for local governments, practically and politically. Issues associated with local municipal companies constitute a special area within the domain of local government asset management and should be addressed accordingly. Thus, if local governments retain ownership of the companies, scope of companies operations would require revision and reduction, along with re-shaping overall relations between local governments and companies. However, ownership might be not the only way for local governments to meet the need to provide local municipal services.

In the context of many former centrally-planned economies, local governments will remain involved in local service enterprises to certain extent. However, the involvement of local governments in other types of enterprises, be these commercial real estate development or flower retail, is not sufficiently justified. Government engagement in various businesses beyond the core municipal services results from a variety of circumstances – residual inertia from an inherited situation, a desire to protect or create jobs, pressure from interest groups close to the city government, pursuit of private interests by members of the city government, and so on. Whatever the reasons are, there are serious arguments against this type of involvement, based on both international experience and contemporary principles of public management, including the following:

- Involvement in business is not a function of government
- Governments are not efficient business entities or owners
- Owning or running business exposes local public resources to un-justified risks.

In particular, the involvement of local governments in enterprises exposes public financial and property assets to financial, business, and economic risks, while rarely producing returns that could justify such risks. Moreover, quite often business enterprises produce regular losses to the local budget and property.

Reshape the relationship

Two seemingly opposite directions of improvements are needed. On one hand, local governments need to improve oversight of enterprises and their performance, which should cover: quality of services to consumers; technical, financial, and management efficiency; accountability of the enterprise management; and investment in maintenance, repair, and growth. Instruments for such improvements include:

- Customer satisfaction surveys
• Better structure and quality of enterprise governance (in particular, broader use of performance based contracts with enterprise as the whole and with enterprise’s Director)
• Better enterprise reporting
• Better strategic planning at enterprise, including capital investment.

On the other hand, local governments should refrain from political and administrative interference with enterprise operating management if the enterprise performs according to objectives and targets set up for it. For example, replacement of enterprise directors based on their political affiliations or other interventions in enterprise personnel practices that hinders enterprise efficiency is not a good practice, according to contemporary approaches to public management.

**Improve business practices**

First, for multi-functional enterprises, clarity of reporting operational and financial results should be improved. In particular, for each “line of business” (street cleaning, garbage removal, parking management, market management, etc.), their full revenues and expenses should be tracked and report separately. The costs of common internal services such as administration, accounting, or repair shop, should be allocated among the lines of business. Having such reporting, local government and enterprise itself will be able to monitor which services are financially self-sufficient, which are profitable, which are in loss. This will create a platform for the local government for better-informed decisions on subsidies to the enterprise from the municipal budget, if such subsidies are really needed and justified. This also will help the enterprise itself to improve their operations and planning.

Second, lines of business that lie beyond the core public services should be privatized or liquidated, to reduce risk exposure.

Further, some lines of business require specialized expertise and approaches, which require further fostering. For example, Annex 3 summarize approaches to parking management. For some municipalities, it might be useful to consider separating parking management and market management into separate enterprises.

**Introduce contractual relations**

In most municipalities contracts on services between local government and enterprises either do not exist (even when they are stipulated in the resolution that established the enterprise) or are not sufficiently good. Municipalities should have a contract with each municipal enterprise regarding services that the enterprise provides to Municipality as a client. The contract should take into consideration real costs of each service provided to the Municipalities. The Contract for Services should define specific obligations of each party. The Contract for Services should include the following key subjects:

1. Subject and term (duration) of the Contract (initially recommended for one year, with a possibility to renewal),
2. Fixed quantity services - Fixed quantity services are defined as those where the quantity of the service to be provided is known in advance for the entire contract period and the payment for these services is specified.
3. Variable quantity services - Variable quantity services are defined as those that the exact volume of services required during the length of this Contract is unknown and depends on actual needs. This Contract establishes a unit cost for each service and the maximum number of units to be provided at this cost. The Supplier is authorized to determine when particular services are necessary; however, the Supplier cannot exceed the maximum number of units
4. Payment procedures - The Supplier should submit a monthly invoice to the Customer for services provided. The invoice should detail the quantity and type of each fixed and variable quantity service provided and the cost of providing each of them. For each variable quantity service provided, the Supplier should provide detail on the specific services provided.

5. Rights and responsibilities of the parties,

6. Control of service quality - Control of the Service Specifications will be carried out by the Customer through data and information provided by the Supplier (such as cost of materials, invoices, work records) and visual inspections.

7. Dispute settlement procedure,

8. Procedure for amending and/or making additions to the Contract,


Further, regarding services for which the Municipality is not a paying client, but costs are recovered from other clients’ fees (parking, markets), the Municipality also needs to have a contract regarding its share of revenue. It should be based on gross income (not profit) paid to the Municipality as the Founder. The municipalities and their enterprises should agree upon the percentage of Markets and Parking gross income to be paid to the Municipality, with an annual review and revision of this share. This should be performance-based contract, which should provide incentives to management if work is done well and penal provisions if the enterprise does not fulfill its tasks.

As a part of this package, the enterprises should finance capital infrastructure related to markets from its own revenues or borrowing, subject to approval by founders.

**Open Competition**

Many local governments do not procure delivery of public services but instead assign this delivery directly to their municipal enterprises. This way they provide monopoly for municipal service enterprises. The consequence often is either low quality of service or high costs or both. An alternative, already introduced in many cities in Eastern Europe and commonly used in the West, can be competitive outsourcing these services. Thus, the Municipality can conduct open competition for selecting a provider of street cleaning or green areas maintenance or garbage removal. Then the Municipality should choose the best bid, that is, the lowest price offered by bidders. Public enterprises should be allowed to participate in competition. Initially, the competition can cover only some part of the city. The contract should also be performance based and be granted for 1-3 years, in order to maintain a competitive pressure on the service provider. Conducting such procurements periodically, municipalities will be able to establish true market prices for services.

Management of properties or facilities that can generate income to the Municipality as the owner (green market), also can be placed for procurement, and a contract should be given to a bidder offering the highest payment to the Municipality (for more details see Activity 6).

**Things to think about:**

Does your Municipality own enterprises that are involved in businesses beyond core municipal services required by law?

If so, what you think about this?

Which of the municipal services can be good candidates for competitive selection of a service provider?
II.5. Activity 5: Property-Related Public-Private Partnerships (PPPs)

Recommendations for implementation:

- **Identify properties or services that would benefit from PPPs**
- **Start from simple short-term PPPs, such as outsourcing of simple services: Design, plan, and launch one or several pilot PPPs, each in a form that is relevant to a specific property/service**
- **After that, consider trying long-term PPPs that involve private investment.**

A worldwide trend in addressing governmental needs to invest in, build, and operate real property and infrastructure for public use is related to a new generation of public-private partnerships (PPPs). For this generation, “PPP” is an umbrella term used for many forms of private sector involvement in the provision of traditionally public sector services, based on contractual relations between the local government and private partner. PPPs can take the form of management contracts, leases, concessions, BOTs (built/operate/transfer) or more complex deals, for example those that include sale-lease back arrangements. Many countries have been making systematic efforts to introduce, promote, and encourage such PPPs. In the U.K. alone, 700 deals have been in the delivery stage and another 61 were in procurement as of September 2011. A large portion of PPPs was initiated by local governments.

The essence of these PPPs is that the government and the private sector establish a long-term partnership to build or reconstruct and then operate real estate, which is used for public purposes (and, in many cases, owned by the government). In particular, the private sector can be deeply involved through the entire life cycle of the property, including financing, design, construction, and operating. Key benefits of such PPPs include:

- The possibility of private finance replacing scarce or lacking public finance on many projects
- Shifting many risks from the public sector to the private sector (including the risk of budget overruns)
- Speedy, efficient, cost-effective delivery of projects (PPPs have built-in incentives for private partners to deliver on schedule or be penalized)
- Efficiencies from integrating design, construction, operation, and maintenance into life-cycle costing (gives 10-20% savings over facility useful life)
- Use of private sector skills for public projects / facilities
- Greater accountability.

However, in 2010s, some countries (e.g. the UK) started revisiting their PPP approach, based on conclusion that better decision making and greater transparency are needed for

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6 C&AG’s Report, Lessons from PFI and other projects, HC (2010-12)
project that require private-sector financing. In particular, to make sure that a PPP is indeed the best solution and that public interests are fairly represented in PPP deals.

Simpler versions of PPPs include short-term (3 – 5 years) contracts that outsource to the private sector providers delivery of some municipal services, such as street cleaning, garbage removal, maintenance of governmental buildings, operation of public parking lots, road repair, etc. Such simple PPPs are recommended as a start for local governments that do not have yet detailed experience in contractual relations with the private sector for acquiring services.

For example, competition in management of farmer markets could be introduced. In particular, a local government could separate one market and place it under competitively selected management. Key for success for such a public-private partnership would be to formulate realistic conditions and technical specifications that would benefit both sides, market this opportunity well to the private sector, and to run an open and honest procurement. One can expect that under well-prepared and executed operation & maintenance contract or concession, the operation would be more efficient, the conditions for sellers and buyers improved, and opportunities for revenue-generation for the Municipality created.

Another municipal service that can be a candidate for outsourcing is operation of municipal parking through concessions. Local government needs to conduct a study on parking in the municipality as a background for a decision whether to place parking service for a concession to a private operator. The conditions should include that (i) operations are self-sufficient initially and later share some percent of income with the city, and (ii) fees are not increased without approval by the Municipality. This public-private arrangement should be defined in details in the concession contract, and the competition for awarding this contract should be carefully prepared, marketed, and conducted.

After a local government gains some experience with performance-based outsourcing of services on the short-term basis, it will be positioned for testing more advanced PPPs. In particular, this approach can be introduced for reconstruction of properties that local governments are legally obligated to own, though their use has a commercial nature or a revenue-generating potential (such as farmers markets). PPPs can also be used for reconstruction of governmental office buildings, reconstruction and management of sport facilities, and construction and operation of infrastructure.
II.5.1. Two Schemes of Selling Development Rights in São Paulo, Brazil

São Paulo funds some long-term projects by proceeds from “sales” of additional land development rights (such as additional building height, coverage or floor area ratio). This practice started in the late 1980s, when developers built low income housing in exchange for the right to add density to these sites. As the instrument evolved, payments from developers were accumulated in a special fund. In the late 1990s, this instrument was ruled unconstitutional and terminated. In the early 2000s, when the present Urban Master Plan was being designed, this concept was integrated in the law through “chargeable granting” (“Outorga Onerosa”). The funds obtained through this instrument are channeled into infrastructure works through the City Special Fund for Urban Development (FUNDURB), which can be applied in any part of the city, for planned capital expenses.

Another scheme for using sales of land development rights is “Urban Operations” (“Operações Urbanas”). The city has five active and eight scheduled projects of this type. All are large (from 100 to 500 hectares) urban development projects, with 15-20 year terms. In each project, important infrastructure works on the project territory are funded by sales of additional land development rights. In the most recent of these projects (Faria Lima and Água Espraiada), these additional rights are sold on the stock market as tradable Certificates of Additional Potential Development (CEPACs, Certificados de Potencial Adicional de Construção). These certificates are issued by the city and sold on auctions. This procedure allows for revenue planning, which is helpful for financial planning and management of infrastructure development. Older operations had these rights valued through appraisal reports, analyzed on a case-by-case basis by city technical staff.


Things to think about:

Which facility or service in your Municipality could be appropriate for a PPP?

What would be the benefits for your citizens from this PPP?

What would be public concerns about this PPPs?

II.6. Activity 6: Improving Land Management and Land Administration

Recommendations for implementation:

- Create and empower a special group to deal with multiple strategy, policy, and technical issues of land management
- Inventory and map all land parcels controlled by the municipality and its institutions and public enterprises, which includes vacant land
- Secure municipal rights for land sites that you want become municipally owned
- Classify all land parcels, including vacant land, as stated in Activity 4.
• Formulate an explicit strategic view at municipal land, develop local policy regarding municipally-controlled land (including vacant land), and make land disposition and acquisition procedures consistent with the policies.

• Develop a strategic land allocation plan for the “other construction land” portion of the vacant land portfolio.

• Make land in your municipality more attractive for investors and market the land better.

• Consolidate land management and improve governance of the entities (departments or enterprises) that manage land.

• Improve management of the portfolios of land leases (long term of the “private construction land” and short term of the “public construction land”).

• Harmonize and improve the system of land-related fees.

Context

Land management is obviously an integral part of overall municipal asset management and in this regard should follow the general framework described in other chapters. However, land management deserves some special and separate attention for three main reasons:

1) In many cases, land represents the most valuable resource that municipalities and their institutions and enterprises control. In particular, quite often, even if a land parcel has construction on it, the larger part of potential market value of this property (i.e. land plus the building) is attributed to the land site, not the building. As stewards of public interest, all public entities controlling land should have a common measure of public wealth entrusted to them, with market value of real estate being a standard measure used internationally. However, municipal property holders in many countries usually do not know this value and do not always allocate property in the best public interest. In particular, local governments routinely allocate vacant land (usually “other construction land”) for various private and semi-public projects free of charge or at administratively established prices, without considering potential market value of land parcels and without attempting to sell land through good marketing campaign and open competition. One of common ways of giving away valuable land is contribution land/property to municipal public enterprises or joint ventures. When land is allocated in this way, new land users capture the land’s market value, without the general public benefiting from this value divestiture.

2) Allocation of “other construction land” to private users is an active on-going process in most municipalities, although many of them do not have good inventories of vacant land. This can realistically lead some municipalities to exhaust available vacant land without recognizing this.

3) Moreover, many municipalities have complicated administrative procedures related to all land transactions (i.e. both municipal-to-private and private-to-private) and issuing land- and construction-related permits. Often, this is coupled with high costs for investors (land development fee and other fees and charges) and creates the discouraging investment climate, thus scaring away potential investors.

Given these circumstances, a very high priority should be assigned to improving land management and land administration. Furthermore, prudent steps to improve land management and land administration can and should be implemented without waiting for information technology tools, such as GIS-related databases of municipal property, to be developed and become operational.
1. Create and empower a special group to deal with multiple strategy, policy, and technical issues of land management

As the rest of this chapter demonstrates, land management includes multiple and quite different tasks – from defining strategic goals of the Municipality regarding land to many very technical and legal issues. For handling them all in a sensible manner, with a focus on achieving specific strategic goals, somebody should develop a “bigger picture” view and goals and than maintain a focus on achieving these goals. Therefore, a special group should deal with land management improvements on a regular basis.

If the general Task Force on asset management is established (see Activity 1), this land management group should be a part of the general TF. However, it should also include an advisory body from the private sector, because it is critical to hear what private investors want to be improved first and foremost. Best of all would be to have in the advisory body 2-3 lawyers in private practice or other intermediaries who are assisting investors to acquire properties for development in the municipality. A local chamber of commerce should also be engaged or, at least, be well informed about suggestions that this land management group will be making. From the municipal side, the group should include:

- Mayor or Deputy Mayor,
- Head of Legal Department
- Head (or Deputy head) of Financial Department
- Heads of all departments / municipal enterprises engaged in land management, land development, and urban planning.

A potential risk in some municipalities is that the municipal (citizens) interests and the interests of the municipal enterprises managing municipal land maybe be in conflict, and land is not managed in public best interests. Specifically, in some countries, Directorates for Construction and Developments (titles can vary) are, legally, municipal enterprises and play very substantial roles in the process of controlling, planning, allocating, and developing vacant construction land (both, public construction land and other construction land). In addition, these enterprises are often involved in administrating land-related revenues and expenses. Meanwhile, governance of these Directorates, as of most other municipal enterprises, is not good enough for protecting the public interests. This implies that, in short term, the policy leaders at the above special group should be the municipal lawyers and financiers, not enterprise representatives. In longer term, key land management functions, such as inventorizing land and making any allocation / holding / acquisition decisions should be made by municipal government itself, with a direct supervision of the local council.

2. Inventory all land parcels controlled by the municipality and its institutions and public enterprises

Inventorizing built-up properties was already discussed under Activity 2. Inventorizing vacant land presents a special challenge because often this land is not identified well in existing records (i.e. in the Land Cadastre or records held by the Municipality and its institutions and enterprises). Moreover, what is “vacant land” should be defined. The common notion of municipal vacant land assumes that the land (i) does not currently have any structures on it, and (ii) does not have legitimate rights to it held or claimed by non-municipal entities, such as leases held by the private sector or restitution claims.

Another group that is similar to “vacant land” in a functional sense is excess land held by various municipal entities, including institutions and enterprises; this land is assigned to them in the past but neither used productively in their current operations nor needed for performing public services in the foreseeable future. In other words, this land can be
interpreted as physically vacant but legally encumbered by rights of some municipal entities. Finally, abandoned built-up properties ("brown-field" land, in the terminology used in some regions) controlled by the municipality or its entities are also close to what can be considered vacant land in the functional sense. These properties are usually known and identifying them for addition to the "vacant land" portfolio is not difficult.

Obviously, vacant land is valuable, as it’s the resource for new private and public land uses, which is in limited supply.

The process of inventorying vacant land includes two parts:

(i) identifying parcels “suspected” to be vacant, and,
(ii) researching whether they are not burdened by third-party rights or claims and, if needed, verifying that they are physically free of structures.

The inventorying process usually results in two initial groups of land plots: one group includes “legally clean” vacant parcels (without third-party rights/claims) and the second group includes plots with some legal uncertainty, sometimes quite complicated. The second group requires legal work, often on a plot-by-plot bases before the municipality can either include the plot in its vacant land portfolio or sign it off from the vacant portfolio as temporary (i.e. lease) or permanently private plots (i.e. restitution or privatization).

• Identifying and mapping vacant land

In practice, how does one identify parcels suspected to be vacant? This depends, to a large extent, on the municipality’s available tools and capabilities. There are at least two contrasting approaches and a wide spectrum in between. One approach is based on physical inspections of the city territory using available maps and can be applied reasonably quickly. The second approach is conducted within the cyberspace of computerized records and images and is based on availability of computerized land records in a GIS-related database.

The essence of the first approach is that individual surveyors are assigned to specific parts of a city, provided with maps of their respective territories, and conduct physical going-through inspections of the territories where they identify, measure, and record all vacant plots and mark them on maps. In the low-technology case, the surveyors work on copies of paper maps with the street grid (the scale 1:2000 in well suitable for this work), which local urban planners provide and do systematic block-by-block visual screening for vacant sites.

A more technology-advanced approach, which is between the contrasting poles, is when the surveyors can use digital cadastre maps with an aerial imaging layer for planning field visits. This allows the surveyors to identify sites to visit in advance and reduces the field inspections from systematic coverage of the entire territory to specific locations. This case requires, however, that the cadastre parcel map with the aerial image underneath it is available to the municipality.

Information from each site resulting from the field inspections should include:

— Location information (as close to a street address as possible; for example: Smeljaniceva Street, between # 35 and 37)
— Size (m2)
— Notes on current use (which will be critical for identifying sites encroached by illegal tenants or land uses).

7 However, this latter type of land is usually called “surplus land” and should be, first, legally transferred under direct control of the municipality, and only after that added to the portfolio of “vacant land”.
8 However, market value of brown-field properties is usually lower than of similar truly vacant sites.
Field results - information per plot - are then computerized in the form currently available to the municipality: a municipal property database if such already exists or a simple Excel spreadsheet, which later can be imported to the database. Furthermore, after the field-collected information for each plot is computerized, it should be extended to include cadastre identification and information on the plot holder. This may take place under the second part of the inventorying process, research and verification (please see below). On further stages of land management, when the list of vacant plots undergoes long-term planning, it may be equipped by further specific information (availability of off-site infrastructure, etc.).

This first approach, based on the systematic going-through identification of vacant land, is relatively inexpensive and quick: one person can survey 10-20 hectares per day, and temporary hires from an unemployed pool can perform work.

Identifying Vacant Land by Going-Through Survey: Hypothetical Example

| City population:         | 50,000 people |
| City area to survey:     | 3300 hectares |
| Daily capacity of one surveyor: | 15 hectares / day |
| Team & time to survey the whole territory: | 5 people working 44 days each |

The second contrasting approach, which identifies parcels to be researched as possibly vacant through database searches based on the layers of parcels, addresses, and aerial imaging information, will be described in a separate document.

Given the importance of the vacant land portfolio for municipal development and the local economy, it is recommended not to postpone the identification of vacant land for information technology reasons, but make this a high priority task and proceed using the available tools. However, it should be well planned and organized. In particular, all holders of information and potential users of this information should be engaged under auspices of reasonably high authority (i.e. the Mayor or City Manager). Also, all realistically available information technology instruments should be reviewed and engaged in this activity. Finally, inventorying vacant land should be clearly envisioned as a part of inventorying all municipal properties.

The results also must be mapped on the map with the street grid, again in the form currently available (either paper or a digital map). Why is mapping of identified plots important? This is important for at least two reasons. First, because plot location on the city map, even if a simple paper map used by urban planners, would immediately help decide which plots are most valuable. This would help establish priorities for the second part – research and verification of which plots are “legally clean.” Starting with the most valuable plots is especially important because the process of clarifying the legal status of sites can be expensive and time-consuming and focusing efforts on land with the most financial and economic potential for the municipality is important. Second, location information is critical for planning the division of the vacant land into the land for public purposes (e.g. schools) and the land that can be allocated to the private sector.

- Researching and verifying that plots are not burdened by legitimate rights of non-municipal entities

This process is more time-consuming than the identification of vacant plots itself. It requires finding the cadastre identification of each plot, which is easier to do if cadastre parcel maps are available in advance when the field surveys are planned; finding information on holders...
of legal rights; and clarifying which claims exist. Nevertheless, even initial results will be very
useful for planning further legal efforts and land allocations (see the box II.6.1 below).

In sum, the municipality needs to have as a minimal result of this initial inventorying activity
some “actionable” list on land parcels, even if it is initially only partial. Later, this list will be
further developed and completed; legal status of plots clarified; and information further
detailed and elaborated for sites offered to investors.

### II.6.1. Regional Experience, Croatia and Kyrgyzstan: Inventorying municipal land

In the City of Split, the official municipal property record increased from zero to 12,500 units,
which were added to the new GIS.

In the City of Jalalabad, 41 plots among 129 plots initially identified as municipal vacant plots
came to have a disputed legal status and required further legal clarification.

A predictable result of creating asset inventories in both countries was that cities started to
intensively address unresolved ownership issues.

#### 3. Classify all land parcels, including vacant, as in Activity 3

Classification of built-up properties has already been discussed. For vacant land, applying
the asset management classification (i.e. in group A-mandatory, B-discretionary, and C-
surplus) has two peculiarities. First, because the land is vacant, classifying it has a clear
planning connotation: each site is becoming associated with a type of future use. Second,
this classification should be combined and fit in with the “public construction land” or “private
construction land” classification. For sites in Group A and C the correspondence is obvious
(please see the scheme below). However, when the municipality is going to classify a vacant
site as Group B (the site needed for performing the functions that are voluntarily supported
and performed for social, political or other reasons), the case becomes more complex and
raises the local policy question: on which construction land, “public” or “other,” should new
properties for discretionary functions be located?

**Example to think about:**

The municipality plans to allocate a vacant plot for a new public tennis court,
which is considered the discretionary function. Should the municipality
classify such land as “public construction land” or “other construction land”?

There is no set rule for cases as in this example, and either option can be acceptable. What
is important, however, is how such classification fits in with financial policies regarding each
type of land. If, for example, the local policy is that surplus property, including vacant land,
should be sold for its market value only and not allocated for free, the plot for the public
tennis court would hardly fit in with such a policy and hence should be built on “public
construction land”. This example illustrates well that the asset management classification (A,
B, or C) becomes most meaningful when combined with specific financial policies regarding
each group, as further discussed in this chapter.

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**Land Classification**
Another example to think about:
To which of the group – A, B, or C - should land sites offered by municipalities for “economic development,” such as “free zones,” be classified?

The challenge is that in many countries, “local economic development” is not considered as a mandatory function of municipal governments and lists it among functions that rather appear as discretionary functions. Therefore, this becomes a matter of a local policy whether municipalities want to designate some municipal land for local economic development or, alternatively, treat any surplus land as land that contributes to local economic development, without any special regime attached to such lands.

**4. Formulate an explicit strategic view at municipal land, develop local policy regarding municipally-controlled land (including vacant land), and make land disposition and acquisition procedures consistent with the policies**

Most municipalities in most countries do not have clearly formulated strategic views on municipal land or policies related to land. This does not mean, though, that such views and policies do not exist – they do exist implicitly, as a matter of practice, but are not articulated, are not transparent to the population and investors, and the municipal governments are not accountable for results of such implicit policies.

Moving to the next stage requires thinking through these policies in some explicit terms and discussing them at both Mayor’s office and the local council. There are six core land policy issues that are relevant for most local governments:

(1) valuing and pricing land while allocating to private users
(2) the procedures used for land and property allocation to private users
(3) which rights are allocated
(4) use of land proceeds
(5) principles of acquiring land from the private sector, and  

(6) transparency of information on land.

It is recommended to develop an explicit local policy that would clearly address these issues. The best would be to have this policy in writing as a part of a local Ordinance on Asset Management and thus becoming a binding document for the municipal executive branch. But even if the policy were adopted as a guiding (not binding) document only, it also would be a good step toward better land management.

Policy issue 1: Valuing and pricing

The common practice in many former centrally-planned economies is that the municipalities do not capture full market value of municipal land and built-up properties while disposing of them to the private sector. Specifically, land and properties are often allocated for free or at below-market prices. This happens when property is contributed into joint commercial projects with the private sector, or given to municipal enterprises that than use these properties and sites for commercial investment projects. This is also the case when land is allocated to private companies at low administrative prices, with an expectation that they will create jobs. Furthermore, even when plots are sold through competitive procedures, the starting prices and resulting auction prices are often below potential market levels, due to artificial limitations on land uses and the administrative system of establishing starting prices. Moreover, sometimes, after competitive sales, municipalities stipulate discounts to buyers in their land lease agreements, which effectively translate into a close-to-zero land lease price.

A separate fee for infrastructure development, which investors must pay in some countries, further complicates the case. Usually it is charged in addition to the auction price and can cost land buyers, in fact, substantially more than the land itself. Furthermore, often this fee is set up administratively and does not reflect just the cost of infrastructure, but, instead, is based on artificial hypothetical calculations that give preferences to certain land uses (e.g. in many municipalities this is individual residential development) at the expenses of other land uses, especially commercial. On average, this fee higher than the cost of new infrastructure. However, municipalities often attempt to attract specific investors by providing them with discounts on this fee if they promise to employ a certain number of workers. However, municipalities usually do not follow up with these investors to check on how this condition was implemented. Overall, the entire system of pricing land for allocation of long-term rights can be quite distorted and can create the very uneven investment climate within each municipality.

The recommended policy regarding valuing and pricing may state:

— Any municipal land plot or built-up property (both directly controlled by the municipality and controlled by its enterprises) should be appraised at its potential market value before being allocated / sold to any private user, given to a municipal entity, or contributed to a joint venture with the private sector.

— Allocation of surplus property, including vacant land for private use should take place in exchange for the municipality obtaining land /property market value paid monetary or in-kind; any deviation from this rule (i.e. giving the property for free or for less than the market value) should be approved by the local council.

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9 A common case in the Balkans.
Municipality should establish and maintain a database of real estate market prices (i.e. an objective information background), in order to monitor the market and price municipal property accordingly.

Policy issue 2: Procedures of land and property allocation

As indicated above, contribution of municipal land into various commercial projects or allocation of land without knowing its potential market value is a common practice. Moreover, quality of marketing the land for sale is really bad in many municipalities, and does not stimulate real competition. For example, a common case is that a public notice of land sales is given for a time that is absolutely not sufficient to attract serious buyers (for example, for 15 – 30 days). The sale procedures themselves are not optimal: the common practice is to collect price offers in sealed envelopes instead of conducting open auctions with live auctioneers. Meanwhile, international experiences in countries with emerging markets had shown that when land was sold on open auctions with live auctioneers conducting sales, prices obtained for land sites were, in general, higher than in sales through sealed-bid offers or directly negotiated sales based on market value appraisal.

This all is not a good public policy, as it practically privatizes public assets without local citizens benefiting from the value of the assets and, often, leads to additional financial losses, particularly if land is used for commercial investment projects turning to loss.

The recommended policy regarding procedures of land and property allocation may state:

- Allocation of surplus land, including vacant land, or built-up property for private uses or contribution of such land/properties in public-private projects should take place only through open competitive procedures (e.g. open auctions or requests for proposals) to bidders offering the highest price or in-kind price equivalent; this policy should apply to both properties directly controlled by municipalities and surplus properties under control of municipal enterprises; (ii) deviations from this rule may be allowed either by pre-approval by the local council or in cases when prior pro-active marketing of the property for competitive sale did not lead to a successful sale.

- If any land plot or property is considered for allocation or contribution without an open competition (except cases when open competitions with aggressive marketing failed), a special valuation and justification demonstrating costs and benefits of such allocation should be prepared and submitted for approval to the local council according to a special form.

- The municipality establishes a special zone consisting of the most valuable lands (a city center area, along main roads, etc.) that is declared an "open auctions only zone" where land can be allocated through open completion only, without exception.10

- Vacant surplus land or surplus built-up properties are not contributed into the capital of municipal public enterprises and are not given to them with any long-term rights, except in the cases stipulated in item (ii) under the first bullet.

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10 Defining the borders of such a zone should become the subject of a special activity conducted jointly by municipal land managers, urban planners, and real estate experts working on the local real estate market.
A hypothetical example below shows how the form mentioned in the 2d bullet above can be used in a typical case of non-competitive allocation of land. This example illustrates that in this hypothetical case such non-competitive allocation really does not have any rational justification and leads to forgone income for the municipality without any social or other benefits.

Example

- Date for which information below is valid (month, year): March 2008
- Property name or type XXX
- Location (address): downtown, on one of central streets (address)
- Size of land site (m²): 600 m²
- Size of building (if any), total floor area (m²): 240 m²
- Number of floors: 2
- Building condition: poor
- Current use of land & building: ¾ of the land site (450 m²) is vacant; the building is occupied by NGOs
- Estimated market value of the property (site & building), if the property were sold on an auction, EURO: the building doesn't have a market value (should be demolished); the site value is estimated as EURO 200 / m² (assuming a long-term lease of land) or EURO 120,000.

Suggested transaction & new use of the property: Give the property to a private investor for building a new commercial office building (the total floor space 1,200 m²), in exchange for a commercial premises for the local government in the new building.

Suggested revenues and in-kind compensation to the municipality under the proposed allocation / contribution scheme: No monetary payment to the municipality by the investor; an office space of 100 m² transferred into municipal ownership in the new office building, 2 years after the land lease signing.

Assessment of the transaction: Net Present Value of all offered benefits together: about EURO 24,000 (assuming that the market value of 1 m² in the new building would be EURO 300/ m² (land including), so the market value of the 100 m² premises received by the municipality will be EURO 30,000, discounted with the 10% rate of return).

Assessment of municipal monetary gain or loss from the transaction, comparing to the case of selling property on an auction: the loss of EURO 95,000 - calculated as = (Estimated revenues from auction sale) – (Net Present Value of the property obtained in the suggested transaction)
– **Other municipal benefits from the suggested transaction not attainable through the auction**: None

– **Suggested justification (explain why non-competitive allocation is the best option)**: Investor’s initiative; no need for the municipality to conduct any procurement.

Things to think about this example:
- Would this be a good deal for the municipality?
- Do you foresee any risks associated with this deal and if yes, which ones?
- Would this deal be better from the local economic development viewpoint than just selling the property in an auction?
- What would you suggest to do with this property?

**Policy issue 3: Which rights are allocated**

Often, municipalities have a choice whether to allocate the lease rights or sell land in private ownership. At the same time, experiences in various countries where such choice exists, including Russia, Serbia, and Macedonia, demonstrate that investors, when they have a choice between ownership and long-term lease, generally prefer ownership. From the municipal viewpoint, having land users own land instead of leasing it would simplify land management, as it will relieve the municipality from the obligation to manage the portfolio of hundreds or thousands of land lease contracts. In addition, municipalities compete for attracting investors, so offering investors ownership rights to land will create a competitive advantage for municipalities that do so.

The recommended policy regarding property rights may state:

- If selling land in private ownership is permitted by law, surplus land suitable for capital construction and municipal surplus built-up properties is sold, as a rule, in private ownership.

- Otherwise, land for capital construction is allocated to private investors, as a rule, for the longest period permitted by law.

With the overall policy oriented toward granting ownership rights to land buyers, municipalities still can grant investors the long-term lease rights instead of ownership and/or leases shorter than the maximum permitted by law in special cases when this is justified.

**Policy issue 4: Use of sale proceeds**

Real estate is capital asset, and income from selling such assets represents capital revenues (vs. recurrent revenues from such sources as taxes). For this reason, good public policy, as recognized internationally in public management, would be to spend this income for funding capital projects related to mandatory functions of municipalities, according to a

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11 Notice that a reference to new jobs and new property tax created by site re-development would be irrelevant, because similar benefits would be generated if the site were sold on the auction.
priority list of public investment, or repaying municipal long-term debt. Similar, but even stricter policy should apply to sales of capital assets by public enterprises.

The recommended policy regarding the use of revenues from land and other real estate sales may state:

— Net revenues from selling land rights are earmarked for budgetary capital investment into priority capital projects related to mandatory functions of the municipality or for repayment of long-term debt. They also can be accumulated in a separate reserve fund for capital projects. Priority projects should be approved by the local council.

— Exceptions from the above policy (i.e. spending of some portion of these revenues on expenses different from the priority capital projects and debt repayment) can be authorized, on a case-by-case basis, by the local council, as a part of the municipal budgeting process.

— All revenues from selling capital assets by municipal service enterprises should be re-invested in capital expenditures in enterprise core functions, according the capital investment plan pre-approved by an enterprise founding body.

Policy issue 5: Principles of acquiring land from the private sector

There are many examples when municipalities or their enterprises buy land for commercial projects (shopping malls, multi-apartment buildings for sale; restaurants, etc.), in hope to develop these sites and start obtaining commercial income. From the viewpoint of good asset management, such acquisitions should not be happening, at least not before all other needs in capital investment in mandatory properties are met. Property acquisitions are capital investments and as such should be a part of careful capital investment planning and a related policy on capital investment, which, ideally, would use the asset management classification for prioritizing capital investments. In a meanwhile, asset management policies should, at least, establish a sound approach to land and property acquisitions and protect the public from non-justified land acquisitions.

The recommended policy regarding acquisitions of land / property from the private sector may state:

— Allocation of municipal funding (direct or indirect, via borrowing) for land acquisitions is a part of regular capital investment planning (CIP), subject to local council approval.

— Land acquisitions / purchases by the municipality or its enterprises from the private sector have to be prioritized depending on the classification of the property / project for which the land is acquired, i.e. groups A, B, and C. Specifically:
  
  o The highest priority have the acquisitions of land for public use (mandatory functions – group A): the acquisitions for these purposes are funded first
  
  o The acquisitions for the discretionally functions (Group B) can be considered / approved as a part of CIP if all needs for Group A are met
  
  o As a rule, acquisition of land for surplus properties / projects (Group C) are not considered at all, even if all capital investment needs for Group A and B met.
— Exclusions and deviations from the above priority policy can be granted by the local council, on a case-by-case basis.

— A land acquisition request can be considered for municipal funding only if it convincingly demonstrates that the municipality or enterprises do not have land sites that could be used for the intended purpose and that non-acquisition solution (such as renting space for the municipal function at the market) is not feasible or economically not justified.

— Acquisition of sites for public purposes should be based on voluntary transactions to the maximum extent feasible.

A process of an involuntary land acquisition (expropriation) can be initiated only as a last-resort solution, according to respective law on expropriation.

— Acquisition of land sites through voluntary transactions should be based on public solicitation of proposals from private sector sellers.

Finally, land allocation and acquisition procedures and practices should be made consistent with and subordinated to the land policy and land allocation plans (the latter are discussed below).

Policy issue 6: Transparency of information on land

Transparency of land transactions and land plans is a matter of both good governance and practicality. From the governance side, transparency of government is one of main features of good public management. In particular, if details of each transaction with municipal property were automatically disclosed to the public, much less abuses of public property and budgets and just bad judgments by local governments would happen. From the practical viewpoint, without transparency of information about land, land management cannot be efficient and prudent, and it is impossible to improve the local investment climate.

The recommended policy regarding information may state:

— The Mayor’s office is responsible for preparing and making available to the local council and the general public quarterly and annual reports on land management results

— A form of reporting should be jointly developed by the Mayor office and the main land managing entity;

— Regardless the form of reports, they should, as the very least, provide clear information on (i) inventory of land under direct municipal control and control of municipal and municipal-private enterprises, and (ii) each site allocated for long term (lease, use, management, private ownership), with full legal and financial data about the transaction, and (iii) sites planned for allocation / sales during the next reporting period.

5. Develop a strategic land allocation plan for the surplus vacant land

As indicated above, allocation of the surplus vacant land to the private sector for new construction should be planned and executed with a long-term perspective in mind, as this is the public resource that belongs to future generations.

• Further classification / planning of vacant land allocation
In practical land management, planning of the allocations of vacant surplus land can include at least four groups of sites, as shown in the scheme below:

- **“Golden reserve”**. This group includes several sites with high market values (current or expected) due to their excellent location, preserved for sales or collateral in the future when the municipality would need to generate funding for large infrastructure investment.

- **Sites for capital construction**. This group should be further split in the group for allocating to the private sector in the upcoming 1-2 years, and the group for later allocations.

- **Small plots / offcuts**. This group includes plots suitable for capital construction only after consolidation with some adjacent sites. This group can be offered for sale to owners of adjacent sites.

- **Sites not suitable for capital construction**. This is due to their location within urban fabric or other condition and can be offered for temporary light-construction uses, based on short- and mid-term lease.

The addressed list of vacant plots classified in this or in any other manner should be approved by the local council and then modified every 1-2 years.

Planning annual land sales should have a budgeting dimension as well: the revenues from such sales should be a part of overall municipal budget planning, as discussed above.

Decisions on which sites should be designated as the “Golden reserve,” released for capital construction in the first 1-2 years, and released later, should reflect market demand, market cycles and price signals. In particular, when market is at a downturn (low demand, low prices), it makes sense to postpone sales of surplus land until the market recovers.

For managing surplus land according to the land price signals, municipalities should start developing and maintaining two functions critically important for general prudent land management:

- **Monitoring & analytical function and capacity**
  This activity should inform land managers at the city level about demand for land and help them to plan land release. The information must be both quantitative and map-based, with location information based on street addresses. Several types of information should be quantified and mapped including land transactions, land prices, and construction activity.
There are several types of maps and accompanying information that land managers should start collecting and then consistently continue, on a plot-by-plot basis:

a) Address (location), size, intended/ permitted use, lease duration, starting and sale price of each plot sold on a land lease auction, and auction date;
b) Address (location), size, intended/ permitted use, lease duration, the starting price of each plot offered and **not** sold on an auction, and auction date;
c) Address (location), size, intended/ permitted use, lease duration, and sale price of each plot allocated through direct negotiations, and the date of allocation;
d) Addresses, sizes, intended/ permitted uses, and reported prices of plots sold through private real estate transactions;
e) Addresses of building permits requested on the territory of the municipality for all types of development and redevelopment activities; and
f) Addresses, size, permitted uses, and land rights granted for parcels where informal construction has been regularized and legalized and the price paid by land users for this, if any.

For the transactions (plots) where the land development fee also was paid, the size of this payment for each plot should be also included in the database.

These data and maps would help municipal land managers to answer two central questions: (i) whether their spatial policy of land release for private development is consistent with spatial demand for construction activity (the latter reflected in territorial distribution of requested building permits), and (ii) whether municipal land pricing policy reflects true market values of land that manifest themselves in private-to-private sales.

Another important factor to consider in planning land releases is land price increase over time. In most urbanized areas, land prices tend to grow faster than general inflation, and in cities with shortage of vacant land, land prices may grow substantially from year to year, sometimes nearly doubling each year. Each municipality should take a good look at the dynamic of local land and real estate prices, in order to understand how much more revenue can be expected from selling some of the most valuable plots not now but later.

**6. Make land in your municipality more attractive for investors and improve land marketing**

No secret, municipalities in most countries compete one with another and with municipalities in neighboring countries for new private investment, both domestic and foreign. Moreover, there are examples when potential investors left to other places being not satisfied by high land-related costs in a particular municipality. It is well known from international experiences that access to land, land rights granted to investors, and land-related costs are the factors defining the local investment climate. So, what can your municipality do to improve your competitiveness on this front?

International experiences suggest that there are two broad – and partly overlapping - areas, where a local government can make improvements. First, you can **improve the investment climate** and, second, you can **market the land in your municipality better**. Some main tools of doing both, tried and tested in many countries, are listed below and detailed in a separate document, "**Guidance on Packaging and Marketing Municipal Land to Investors.**"

However, you need to prioritize your efforts, and for best results it is critical to solicit and factor in opinions of private investors and real estate developers on what they consider as the most urgent improvements of the investment climate in your municipality.

How good or bad are investment conditions in a particular jurisdiction is a relative notion that investors assess against other places. Therefore, it is useful for local governments to start
benchmarking themselves against other municipalities\textsuperscript{12}. Below we suggest three benchmarking indicators of the local investment climate.

**Improving the investment climate** implies reducing investors’ direct and indirect costs associated with land acquisitions and construction, reducing administrative limitations on what investors can do on the land they hold, making a whole municipal interface welcoming and friendly to investors, reducing various uncertainties for investors, and improving long-term security of the private investment. Specifically:

1) **Reduce direct land- and construction-related costs administratively imposed by governmental entities.**

There are two benchmarking indexes useful for monitoring your municipality’s comparative position that can be derived from this worksheet:

   a. The percentage of all land costs (i.e. “land purchase price” and “other land-related costs” together) in the total project cost, and

   b. “Other land-related costs” as the percentage of the construction cost.

2) **Level fees and charges related to infrastructure for all types of land use and reduce them to the cost-recovery level.**

3) **Level initial land lease prices for all types of land use.**

4) **Let auctions define land prices.**

5) **Reduce indirect land-related costs, i.e. costs induced by a need for investors to deal with multiple permits and fees, usually processed and issued by different entities and at different locations.**

   An important benchmark indicator of these indirect costs, broadly used internationally, is

   \textit{The time (in days) needed for ordinary investors / buyers to obtain all needed documents and permits, from a day of an auction (or a private-to-private purchase) until a day when construction can start.}

6) **While offering municipal land, formulate permitted land uses and parameters of construction in broader categories than under the current practice**

   This is the issue of reforming land use planning and land use control toward a more demand-driven and market-friendly system. For many former centrally-planned economies, with intense regional competition among counties and a need to re-vitalize local economy, the matter is quite serious: countries just cannot afford a burden of their current urban planning and land use control system\textsuperscript{13}.

7) **Increase certainty and security of investors’ rights by selling land in private ownership and, in interim, improving the quality of land lease contracts for long-term leases.**

\textsuperscript{12} Benchmarking is the process of comparing the cost, time, or quality of what one organization does against what other organization does.

\textsuperscript{13} This problem is typical for many post-socialist countries; for example, it was well documented and argued regarding India. Thus, McKinsey, based on 10 years of research in India, argues ("India: The Growth Imperative," - Presentation at the World Bank, April 2002), that unrecognized land market distortions, including inflexible land use zoning, subsidized land rent, and protected tenancies, along with unclear property rights – all of which are typical for many other countries - are among key barriers to economic growth.
Better marketing of land by a municipality is a process that can have many various elements and can be more pro-active or less pro-active. Moreover, it can target the land owned by a municipality itself and its enterprises only, or, alternatively, include land controlled by private enterprises as well. Some marketing elements that can be useful to many municipalities are as follows (see details in “Guidance on Packaging and Marketing Municipal Land to Investors:”

8) Improve market exposure of each land site for sale.

9) Improve the quality of materials about sites and their usefulness for potential buyers.

10) Improve some other elements of the auctioning process.

11) “Package” sites for sale. The concept of “packaging” is that a municipality, in order to make land more attractive to investors / buyers, takes upon itself some work that investors / developers usually have to do themselves. As a result, buyers obtain not just a site, but rather the site with extra services or documents.

12) Launch pro-active marketing of the entire portfolio of land available for investors.

7. Consolidate land management and improve governance of the entities (departments or enterprises) that manage land
Similar to asset management in general, land management often is very fragmented and convoluted. For example, several municipal entities can be routinely involved in leasing land. How to consolidate land management and simplify and streamline related procedures, should be specially designed, and may vary depending on a specific current practice in a municipality. Suggesting options for better organization of land management should be one of the key tasks for the special group mentioned in the beginning of this chapter. Obviously, this task should be addressed in conjunction with overhaul and consolidation of asset management in general discussed under Activity 13.

8. Improve management of the portfolios of land leases

Managing large portfolios of rental properties presents a wide range of challenges that are discussed in detail under Activity 10, which is dedicated to commercial rentals. Issues related to managing land leases are similar, to a large extent, to issues of commercial rentals, with the difference that in some countries, the municipal portfolios of land leases can be substantially larger than portfolios of commercial rentals.

Specific to land leasing is that there are two sub-portfolios that should be clearly distinguished and managed differently: the long-term leases on “other construction land”, which allows capital construction, and leases on public construction land for temporary short-term (up to 5 years) uses, such as street kiosks.

For specifics on managing rental portfolios, readers should refer to the chapter on Activity 10.

Things to think about:

In your municipality, how would you approach identification of vacant land under control of the municipality and its entities?

Do you know how much vacant land (the number of plots and their area) your Municipality allocated to private investors during the past year?

Do you know any case(s) in your municipality during the past 3 years when land sites were given to investors without auctions?

How do you view these transactions: as a gain or a loss to the Municipality? What would you do differently, if anything?

II.7. Activity 7: Real Estate and Business Appraisals

Recommendations for implementation:

- Develop appraisal expertise among asset managers so that they can act as “educated clients” for professional appraisers or make rough estimates themselves
- Identify all real property units that will be (potentially) alienable; conduct systematic appraisal of their market values
• Conduct pilot appraisals for several properties, selecting those which appear to be either the most profitable or the most problematic and resource-draining for the local government; use these pilot appraisals to begin a systematic appraisal of all properties

• Consider appraisals of life-cycle costs for non-alienable properties

• Consider appraisals of the local government’s business interests in various enterprises

Identification of appropriate values for various government-owned properties

The key starting question for property asset managers is which values they need to know. In general, there are two groups of properties. The first (and biggest) one includes properties that can be alienated (sold), at least potentially; most government-owned properties belong to this group. For these properties, knowing the market value of the property is key to monitoring and controlling performance. As part of the real property asset management process, the financial performance of each particular property is evaluated against the market value of the property.

For local government properties that are not alienable under any reasonable assumptions (such as bridges and other engineering infrastructure), the contemporary approach is to estimate the so called life-cycle cost, which consists of the construction cost and the cost of maintenance and repair of the property during its life time.

An important conceptual issue to recognize is that accounting (bookkeeping) value of real property has limited meaning for prudent decision-making processes in asset management. Traditionally, accounting values are calculated as the historic cost of acquisition or development, reduced by depreciation calculated by formula. More advanced accounting practices may also incorporate periodic adjustment of initial construction costs for inflation. Nevertheless, book value of property, as a rule, has no connection to the current market value unless it was incurred very recently. The book value does not represent the life cycle cost either.

Contemporary property valuation practice relies on three main methods of appraisal or approaches to estimating market value, each used to the extent that recent valid and relevant data are available:

1. Cost approach, based on estimates of the replacement cost. This approach adds the estimated construction cost to replace the building (including architectural and other “soft” costs) to the market value of the land. This approach often sets an upper limit on value because, if other approaches indicate a higher value, more property will be developed at the lower cost until equilibrium is reached.

2. Sales comparison approach. This simply answers the question, “What have other similar properties produced as a sale price when offered in the open market?”

3. Income capitalization approach. In its simplest form, this approach uses the formula Value = Cash Flow/Required Rate of Return.

Each of these approaches is only that, an approach. An appraisal is an estimate of value, not a determination, and the estimate is based on all relevant data. An appraisal based on
multiple approaches to value is more credible than an appraisal based only on one approach.

It is very important to remember that the appraisal is only an estimate of value. Value is determined in the marketplace as buyers and sellers negotiate actual transactions.

Different property types may require an emphasis on only one or two approaches. Here are some examples to guide an appraiser in determining the appropriate approach:

- **Apartments and houses not rented**: Sales comparison approach is probably best. The Cost approach may be helpful, but for older properties it may require too great an adjustment for depreciation to be helpful.

- **Business rental property**: Income capitalization and sales comparison. Again, the cost approach may be useful for newer properties.

- **Vacant land**: Sales comparison is the main practical approach, because there is no income to capitalize and there is no construction. However, the approach called residual land value can be used as well.

An important methodological issue related to valuing local government properties is to introduce into local government regulatory documents and practice the notion of property market value, as it is understood in international practice and within the private sector in the country. The problem is that sometimes local governments use non-standard definitions, which result in underestimating the wealth concentrated in local government’s real estate and distorts city’s ability to judge correctly about its equity position.

**Professional services**

A policy for developing and using professional expertise for appraising local government property may incorporate several elements. First, the local government needs to train local government staff involved in asset management in the basics of property valuation (both real estate valuation and business valuation) in order to have within the local government “educated clients” for appraisal services. Moreover, asset managers should be able to make an educated guess on the values of the properties that they manage, for the purpose of conducting a preliminary analysis. Second, when professional appraisers are involved, they should be engaged on a competitive basis only; using pre-qualification procedures may help select the most qualified professionals for participation in these competitions. Finally, using two or three different appraisers for valuing different properties of the same type would help compare the quality of appraisal reports and estimated values.

**Identification of the priority of properties to be appraised**

Valuation of government-owned properties has a number of specifics that make this valuation a difficult task within asset management. In particular:

1. Not all public properties have trade potential or private sector comparable sales.
2. Many assets have social worth (“social value”) that is difficult to quantify.
3. The value of public property depends on classification and restrictions.
4. Standards for valuing public property are difficult to introduce and support.
5. Valuation is an expensive process, especially when well-documented appraisal reports are prepared by court experts; therefore the cost to the taxpayer is considerable.
Given the high costs, appraisal requires prudent decisions on how to proceed. It is essential to obtain an appraisal in a case involving legal proceedings, using real property as collateral (security) for a loan, and disposal of assets without open competition. For other cases, the cost of an appraisal might exceed expected benefits, and before proceeding, qualified asset managers should make the preliminary analysis (which may include an educated guess on the values of the properties that they manage) in order to identify properties where the appraisal is needed most urgently. This is an example of the need for intelligence and creativity in the mind of the asset manager.

The term **apraiser** applies to those who have studied appraisal and have demonstrated competence in appraising properties. Others such as brokers may have lesser qualifications in appraisal but may have experience in real estate transactions that provide a basis for understanding property values. Such individuals may be sufficiently qualified to estimate values of properties of lesser importance provided that the asset manager takes adequate precautions to protect against biases and conflicts of interests. For example, a broker should not be asked to provide a value of a property and then be asked to sell it. An investor may have experience with values but should not be asked to appraise a property on which he or she might subsequently seek to buy.

It is easy to get distracted by terminology. Do “appraisers” provide “appraisals” and brokers or others not qualified as appraisers provide “valuations?” Even within the English-language world, there are traditional differences in terminology.” Appraisers” in the U.S. are “valuers” in the U.K. Such distinctions may be unproductive. The important issue is to identify the appropriately qualified individual for each assignment, all in the context of importance and cost.

The department responsible for asset management should adopt a policy regarding valuation, including the identification of assets to be appraised, the frequency of appraisals, the qualifications required of appraisers, and special circumstances in which an appraisal is required.

The following may be elements of such a policy:

- Each asset must be assigned a value, either as determined by a qualified appraiser, by another independent individual experienced with such properties, or by an asset manager.
- Market value, not replacement cost, is the necessary conclusion.
- Priority for obtaining appraisals should be placed on larger properties and those under consideration for sale. The other properties in the portfolio should be appraised, or have values assigned, over the subsequent two to three years. Individual residential units, small vacant lots, and other assets of lesser perceived values may be assigned a lower priority for appraisal or valuation, but the asset manager may immediately assign a preliminary value based on experience.
- Consideration for selecting appraisers and others providing values include importance of the property in the portfolio, the significance of the valuation (for example, a sale is more significant than simply maintaining a complete record of asset values), and cost of preparing the valuation. In some circumstances, a real estate broker or other person familiar with property values may be retained rather than a fully qualified appraiser, but such a person should have no present or anticipated future involvement with the property that would impair the independence of his or her judgment of value.
• Each valuation should be reviewed periodically (once in 2-5 years) by the asset manager. If property or market circumstances have changed significantly, a new valuation should be obtained, either from an appraiser or another sufficiently qualified person.

• For every property, a new appraisal should be obtained at least every five years.

• Each property scheduled for a transaction (even if it is an exchange with another government agency or contribution to a municipal enterprise) should be appraised before the transaction.

• For purposes of objectivity, the same appraiser should not be retained to repeatedly appraise the same property. However, an appraiser may be assigned other properties to appraise in subsequent years. Likewise, the same appraiser should not be retained to appraise all properties in the portfolio.

• Newly assigned appraisers should not be given the analysis of previous appraisers to review but should be required to perform their own analysis to maintain objectivity. However, all relevant facts about the property known to the asset manager should be given to the appraiser. These include architectural and engineering drawings, income and expense data, information regarding physical condition and defects, and similar information.

• An appraisal should be conducted by an independent appraiser or another professional with market valuation experience prior to any significant financial transaction such as a sale, major lease, significant capital improvement, or financing (mortgage loan) and in the case of legal proceedings.

• Some properties may be of such low value that the cost of a formal appraisal would be disproportionate to its value, perhaps even exceeding its value. The asset manager must use sound judgment in determining those larger assets for which independent valuations are required and those less significant for which a valuation can be prepared by the internal asset management staff.

• It may be appropriate to obtain an independent appraisal or other independent valuation of a sample of small properties if the portfolio includes many similar small properties that, individually, would not justify the cost. The appraisal of a sample will provide guidance to the asset manager in assigning values to the other similar properties.

• A goal should be to remove the temptation by asset managers to inflate the value of their portfolio in a way that would reflect well on themselves and their personal importance.

II.7.1. Which appraiser would you choose? (A little humor.)

You need an objective independent appraisal of a property and invite three candidates to present their qualifications and describe their method of appraisal.

The first candidate is invited into your office. You ask him about his experience and methodology. After describing his experience, he says he would conduct an engineering study to determine the cost to build such a structure.

The second candidate, similarly queried, says she would conduct a study of sales of similar properties, analyze the cash flow, and estimate the cost of replacement. Then she would use her best judgment to estimate the value of the property.

The third candidate, when asked, closes your office door, looks around to assure that no one else is in the room, and then quietly whispers, “What would you like the value to be?”
• Develop an overall approach to the process of appraisal; in particular, to deciding which properties should be appraised first, how often re-appraisals should be done, and how the appraisal effort will be divided between municipal asset managers and professional appraisers.

• Develop a special database to contain data on sales of the local government’s properties, which would allow keeping detailed information on local government’s properties sold. This database should contain the address, size, use, physical characteristics and condition, date of sale, price, sale expenses, and sale circumstances for each sold property.

• Begin the systematic appropriation of budget funds for paying for the appraisal of local government-owned properties.

II.7.2. Practical Implication: Appraisal Practice in Former Centrally Planned Economies

In some post-socialist countries, appraisal practice is still heavily influenced by replacement cost. Under a command economy, there is no formal market to use as a basis for appraising an asset. Replacement cost, however, is a constant presence. Resources are always scarce. In the absence of sales data, the cost of new construction is used as a proxy for value.

It has been said that, “In America, you have over two hundred years of data on which to base an appraisal, and here in our municipality we have only a few recent sales.” But appraisers in established market economies rely on data from only the most recent sales. Old information is worth very little. Many appraisers in reforming economies say they use the three traditional approaches to value, but still revert to relying almost exclusively on the replacement cost approach.

It is very important to recognize this tendency to use the replacement cost approach and neglect the sales comparison and income capitalization approaches. Those who contract for appraisal services must be aware of the need to fully consider all three approaches and demand that their appraisers use these techniques as appropriate.

Sample Property Appraisal

Here are some facts:

The City owns a building with a land site that had been used for a kindergarten, but recently it had been closed because few children attended. Here are property details:

- Land area: 500 m²
- Building area: 2200 m²

Information gathered in the market on other land sales:

<table>
<thead>
<tr>
<th>Parcel Size (M²)</th>
<th>Sale Price</th>
<th>Comparison</th>
</tr>
</thead>
<tbody>
<tr>
<td>A 1,500</td>
<td>2,250,000 &lt;currency units&gt;</td>
<td>Better</td>
</tr>
<tr>
<td>B 3,000</td>
<td>3,000,000 &lt;currency units&gt;</td>
<td>Similar</td>
</tr>
<tr>
<td>C 2,500</td>
<td>2,000,000 &lt;currency units&gt;</td>
<td>Poorer</td>
</tr>
</tbody>
</table>

Construction costs (according to engineers) 4,500 RSD/m²
Expected life of new construction 50 years
Effective age of building 10 years

Cost approach

The land value can be estimated by calculating the prices of other land per square meter as follows:

<table>
<thead>
<tr>
<th>Parcel</th>
<th>(&lt;\text{currency unit}/m^2&gt;)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1,500</td>
</tr>
<tr>
<td>B</td>
<td>1,000</td>
</tr>
<tr>
<td>C</td>
<td>800</td>
</tr>
</tbody>
</table>

Using the comparisons shown above (better, similar, poorer), a fair estimate of the land value could be 1,000 \(<\text{currency unit}/m^2>\) or 2,200,000 \(<\text{currency units}>\) for the 2,200 m² site.

The cost of replacing the 500 M² building (4,500 \(<\text{currency unit}/m^2>\)) is 2,250,000 \(<\text{currency units}>\). But it is ten years old. Assuming a fifty year expected life, a depreciation factor of twenty percent (450,000 \(<\text{currency units}>\)) must be deducted (ten years divided by fifty years = twenty percent). Thus the value of the structure is 1,800,000 \(<\text{currency units}>\).

So the cost approach indicates:

- Land 2,200,000 \(<\text{currency units}>\)
- Building 1,800,000 \(<\text{currency units}>\)
- Total 4,000,000 \(<\text{currency units}>\)

Additional facts:

Here are data on similar (in permitted use, location, and condition) properties that were recently sold:

<table>
<thead>
<tr>
<th>Property</th>
<th>Building Size</th>
<th>Net Income &lt;\text{currency unit}/M²&gt;</th>
<th>Sale Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>400 M²</td>
<td>1,200</td>
<td>4,000,000</td>
</tr>
<tr>
<td>II</td>
<td>300 M²</td>
<td>1,350</td>
<td>3,520,000</td>
</tr>
<tr>
<td>III</td>
<td>600 M²</td>
<td>1,150</td>
<td>5,100,000</td>
</tr>
</tbody>
</table>

Other facts

- Market vacancy rate 5%
- Land availability Scarce
- British gilt rate 4.2%
- Price of chocolate in Zurich 60 Euro / kg

Sales Comparison Approach

For simplicity, we will assume that these properties are truly similar and need no adjustment for quality, location, etc. Here are the prices per M² of each of the other properties:

- I 10,000 <\text{currency unit}>/M²
- II 11,733 <\text{currency unit}>/M²
- III 8,500 <\text{currency unit}>/M²

With this data, it is reasonable to conclude that the subject property (the one being appraised) is worth 10,000 <\text{currency unit}>/M², or 5,000,000 <\text{currency units}> under the sales comparison approach.
**Income Capitalization Approach**

We must determine a market-based capitalization rate. Here is what we know from the information gathered so far.

<table>
<thead>
<tr>
<th>Comparable Property</th>
<th>Income &lt;currency unit&gt;/M²</th>
<th>Value &lt;currency unit&gt;/M²</th>
<th>% Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>1,200</td>
<td>10,000</td>
<td>12.0%</td>
</tr>
<tr>
<td>II</td>
<td>1,350</td>
<td>11,733</td>
<td>11.5%</td>
</tr>
<tr>
<td>III</td>
<td>1,150</td>
<td>8,500</td>
<td>13.5%</td>
</tr>
</tbody>
</table>

We could conclude that a market return is 12.5% (.125).

Because the property has not been leased, we must estimate a rental income. The incomes on the comparable properties shown above suggest a likely income of 1,200 <currency unit>/M², or 600,000 <currency units> for the 500 M² building.

Using the formula of Value = Income/Capitalization rate, we find 600,000 <currency units> / .125, or a value from the income capitalization approach of 4,800,000 <currency units>.

**Here is a summary of the approaches:**

- **Cost** 4,000,000 <currency units>
- **Comparable Sales** 5,000,000 <currency units>
- **Income Capitalization** 4,800,000 <currency units>

Now it becomes a matter of judgment, and not a formula. An experienced appraiser will look at this data and arrive at an estimate of value, perhaps 4,800,000 <currency units> in this example.

What did we do with the information regarding the British gilt rate and the price of chocolate? Nothing! In any appraisal, a great deal of data is found. But some of it is simply irrelevant and must be ignored. Good judgment determines which data is used and which is discarded.

In this example, the cost approach was far below the other two approaches. Perhaps we underestimated the value of the land or construction costs, or overestimated the amount of depreciation. Perhaps the comparable properties were not actually comparable. A great deal of thought and judgment is always required of the appraiser to reach a final conclusion.

Extensive information on appraisal is available from a variety of sources. In particular, the Appraisal Institute has many books and other reference materials in various languages available through its website www.appraisalinstitute.org. Internationally, TEGoVA (The European Group of Valuers’ Associations) and IVSC (International Valuation Standard Councils) represent the most prominent international activities focused on introduction of unified and internationally accepted standards in appraisal practice. More on their activities can be found on www.tegova.org and www.ivsc.org.

Later, when the appraisal profession in your country matures and becomes compliant with internationally adopted appraisal standards, selection of appraisers for the most serious cases should be related to appraisers’ credentials that guarantee that he or she performs according to these standards.
Things to think about:

Why is property value information important?

Who estimates value? Who determines value?

What is the difference between bookkeeping value and market value, and why is this difference important?

What are the three main approaches to value, and which ones are more relevant for different property types?

What kinds of information are necessary to prepare an appraisal?

In what circumstances is a professional independent appraisal necessary? Likewise, when is it appropriate for asset management staff to estimate value?

Independent appraisals are expensive and resources are limited. How are priorities established?

II.7.3 Regional Experience, Croatia

**Appraisal of assets**
The ratio of book value to market value on average was one to five. In some extreme cases, the ratio of book to market value was one to 200.

**Market value and revenues**
The asset management model was implemented in 24 local governments. As a result, a total of $2.3 billion worth of physical assets were inventoried and were more effectively and transparently managed by participating local governments. In 2006 alone, these assets generated $77.5 million of income to local budgets through improved management, maintenance, lease, rent or sales.

II.8. Activity 8: Property accounting and financial planning (Operating Statements for Properties or Portfolios)

**Recommendations for implementation:**

- Systematically use operating statements for all properties (and premises)

- In the operating statements, all relevant revenues and expenses for each property and, in particular, management costs should be included

- Property management software should be used, particularly software that is available and used in your country and that is supported by the private property management companies and their associations
- For portfolios of homogeneous properties (such as rental plots on other construction land), a portfolio-level income statement should be produced.

- Prepare an annual budget or financial plan for each property, and then conduct a regular comparison and analysis of the actual and planned performance of the asset.

The purpose of operating statements is to evaluate financial performance of each property and identify poorly performing properties for corrective actions.

A problem in local governments in most of countries is that financial performance data are seldom collected on a property-by-property basis. Very often, data are not collected (especially about expenses) or presented at the aggregated level. Therefore, it is essential for the local government to introduce and continuously use formats for operating statements.

For real property asset management purposes, typical operating statements will consist of a summary of income and expenses. It is important to be flexible in formatting the statement, adding or deleting classes of income and expenses as appropriate. It is useful to establish the report so that the actual results can be compared item-by-item with the budget and with the results from the previous year. The typical report contains at least two columns of data: (a) current month results and (b) cumulative year-to-date results. Below is an example of such a report. In this simple form, it does not include the comparisons noted immediately above, but such comparisons only require adding the columns with such data.

### Sample operating statement

#### Revenues

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Potential Income (1)</td>
<td>1,000</td>
</tr>
<tr>
<td>Less Vacancy Loss (2)</td>
<td>50</td>
</tr>
<tr>
<td><strong>Effective Gross Income</strong></td>
<td><strong>950</strong></td>
</tr>
</tbody>
</table>

#### Operating Expenses (3)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repairs</td>
<td>100</td>
</tr>
<tr>
<td>Heat</td>
<td>60</td>
</tr>
<tr>
<td>Electricity</td>
<td>50</td>
</tr>
<tr>
<td>Water</td>
<td>20</td>
</tr>
<tr>
<td>Trash Removal</td>
<td>20</td>
</tr>
<tr>
<td>Insurance</td>
<td>30</td>
</tr>
<tr>
<td>Taxes</td>
<td>50</td>
</tr>
<tr>
<td>Communal Fee</td>
<td>30</td>
</tr>
<tr>
<td>Property Management Fee</td>
<td>50</td>
</tr>
<tr>
<td>Miscellaneous (4)</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td><strong>420</strong></td>
</tr>
</tbody>
</table>

Net Operating Income 530

#### Financing Costs

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage Interest</td>
<td>90</td>
</tr>
</tbody>
</table>
Overhead Costs

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appraisal</td>
<td>10</td>
</tr>
<tr>
<td>Other (5)</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total Overhead</strong></td>
<td><strong>15</strong></td>
</tr>
</tbody>
</table>

Net Income

- Less Mortgage Principal Payments (6) 100

Cash Flow (7) 325

Notes

1. Effective Gross Income includes actual rents and other income plus amounts that would have been collected if vacant spaces were leased. This income can be further broken down into types of income such as rents, late payment fees, vending machine revenues, copying charges, etc. If rents are artificially low to provide a subsidy to the tenant, that subsidy may also be included as an addition to the amount actually collected.

2. The amount of rent lost due to vacancy and collection losses, as well as subsidies in the form of rent reductions included in the Gross Potential Income above.

3. The categories under this heading should be modified to include other types of expenses. Some of those listed may be unnecessary and can be deleted.

4. Miscellaneous expenses are those that do not fall into any of the other expense descriptions but are too small to justify their own line item description.

5. This category may include certain accounting, legal, and other charges that are incurred as a result of the requirements of the owner but that are not necessary for the successful operation of the property.

6. Mortgage principal payments require cash but add to the wealth of the owner by reducing the outstanding debt on the property. Conversely, interest payments, while requiring cash, do not reduce the debt and are therefore do not enhance the wealth of the owner. Debt is a result of the circumstances of the owner. The property itself can operate equally with or without the debt.

7. Cash flow is the amount of cash, positive or negative, received by the owner as a result of holding the investment.

For the purpose of simplicity, depreciation is not considered as an expense in this sample statement.

For properties that are not income-generating, cash flow will always be negative but it still important to know it for comparisons with other properties, especially of the same type. For example, the costs of operating a rental office building may be similar to the costs of operating City Hall. By comparing detailed operating costs, it may be possible to identify costs that can be reduced.
For local governments, net operating income represents the relevant measure of performance for the property. It is expected that income and expense items will have an attached detailed breakdown of transactions.

It is of utmost importance that local government personnel produce such statements for all of the properties if they manage properties themselves. If property management has been outsourced to external property managers, they should be required to present operating statements. Property managers may already have all the capacity needed to submit appropriate reports, but fail to do so because of lack of interest of property owners or lack of understanding of the capability of their systems. There can be good accounting software packages available in your country that will accomplish the objective of sorting and maintaining data. Of course, each is dependent on accurate input. It is strongly advised that, if a new system is being acquired, one be chosen that is widely used in the country so that training and support will be available.

Along with monthly reports, cumulative reports for the year to date for each property should also be attached. It is important for the asset manager to have an overview of an extended period, since this is essential for monitoring trends in use and performance of the property.

### II.8.1. Regional Experience, Croatia: Monitoring Financial Performance in the City of Varaždin

The City of Varaždin has instituted property accounting for housing, sports facilities, and business rental property, and was introducing it for other types as well. Property management plans are institutionalized, containing activities and financial data for each property. Also, rental practices were improved by more careful monitoring and reduction of vacancies and better tendering procedures. This and other steps have contributed to a 25% increase of gross income from business rentals, from about 4 million Kuna to about 5 million Kuna. Further, costs associated with managing the apartment portfolio have been reduced by about 100,000 Kuna.

### Exercise: Use of Operating Statement Data

You are managing several similar buildings used for the same purpose. You have the following information from Operating Statements and other sources of information.

<table>
<thead>
<tr>
<th>Building Number</th>
<th>Size M²</th>
<th>Heating Cost &lt;currency units&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>450</td>
<td>5250</td>
</tr>
<tr>
<td>2</td>
<td>175</td>
<td>2150</td>
</tr>
<tr>
<td>3</td>
<td>380</td>
<td>4510</td>
</tr>
<tr>
<td>4</td>
<td>410</td>
<td>4980</td>
</tr>
<tr>
<td>5</td>
<td>525</td>
<td>6180</td>
</tr>
<tr>
<td>6</td>
<td>325</td>
<td>7480</td>
</tr>
<tr>
<td>7</td>
<td>220</td>
<td>2680</td>
</tr>
<tr>
<td>8</td>
<td>350</td>
<td>4240</td>
</tr>
</tbody>
</table>

What generalization can be drawn from this information?

Can you identify an opportunity for improvement? If so, what steps would you take to make that improvement?

(Suggestion: Begin by calculating the heating cost per M²)
II.8.2. Regional Experience, Croatia: Operating Statements

On average, tenants paid only 45 percent of their rent to local governments. By introducing operating statements and other measures, local governments were able to increase payment levels to 95 percent. In Split, for example, by introducing operating statements and related measures, ongoing revenues in 2005 increased by 13 percent, while management expenditures were reduced by 6 percent.

Things to think about:

Why is it important to maintain operating statements? How are they useful?

What can happen to make operating statements misleading or inaccurate?

Why is it important to maintain operating statements on non-income producing properties like City Hall and kindergartens?

How are operating statements useful in the process of preparing an appraisal?

Why is it important to have one office being fully responsible for financial information on a property?


Recommendations for implementation:

- \textit{Train asset management staff at the local government to use basic analysis of property financial performance and than discounted cash flow analysis}

- \textit{Before property-by-property financial information becomes available, conduct an analysis of annual results regarding revenue, expenses, and net income (losses) based on aggregated (portfolio-level) data.}

- \textit{To the maximum extent possible, consider portfolios of homogeneous properties (separate subsidized and not subsidized properties)}

- \textit{Include in the analyzed data all relevant revenues and expenses for each portfolio (in particular, management costs).}

\textsuperscript{14} Additional discussion of indicators used by asset managers is provided in Annex 5
As discussed under Activity 3, the local governments’ property portfolios are very diverse in their content, size and character. They contain land, residential properties, office buildings and premises for governmental and semi-governmental use, non-residential (business) rentals, sport and cultural facilities, kindergartens, farmer markets, lighting infrastructure, industrial and warehouse/distribution real estate, and various enterprises.

In addition, local governments undertake projects, most of which include development of some kind of real property. It is self-explanatory that such diversity of portfolios and projects has to be closely monitored and controlled, in order to achieve appropriate benefits and avoid financial losses and deterioration of properties. The primary means of achieving desired management objectives is to conduct a feasibility study, which includes the analysis of expected financial consequences for the local government, before engaging in any business, investment, or construction project.

It is possible to obtain professional literature that describes the content of feasibility studies in depth. Formats of these studies may vary, depending on the character of the project.

By introducing operating statements and relevant financial reporting on property (on the issue of reporting, please see Activity 12), the local government will consolidate essential information on income and expenses for each property. (Currently this information is dispersed within the local budget reports and cannot be extracted from there efficiently and reliably.) The city then receives the benefit of knowing the net income (cash flow) from the property. Properties that produce no income but incur expenses will have statements that show the details of the “loss” that is incurred or subsidized by the local government.

Within current common practice, general budget reporting is not oriented toward property.

**Tools for the analysis of income-generating (surplus) property**

Income-generating (surplus) property should be treated as investment property and, as such, analyzed against other feasible investments. The underlying logic is very simple and straightforward: The municipality does not need this property for its functions, and if it retains some specific property, this property should produce returns on investment, which are competitive - after considering risk factors - against other available investment types (bank deposits, State securities, etc.). If the property is not generating sufficient returns, its performance should be scrutinized in order to see how the property performance could be improved. If improvement is not resulting in higher returns, the owner should consider selling the property and reinvesting proceeds in another type of investment.

There are two basic tools for analysis of income generating property.

**Tool 1**

The simplest one is based on a “triangle formula” for one-year analysis:

\[ R = \frac{I}{V}, \quad (1) \]

where \( R = \) capitalization rate, \( I = \) income, and \( V = \) value

The concept is that each of these three characteristics can be calculated if the other two are known. In particular, the capitalization rate (a simple rate of return) \( R \) can be calculated if annual income and property value are known (estimated). \( R \) (capitalization rate) can be used as a rough estimate of investment performance for one year. A key for the correct use of this rough estimate is to understand that \( I \) (income) should be net operating income. A version of
this triangle formula was used in Activity 7 in the Income Capitalization approach in preparing an appraisal.

Net operating income or net cash flow (see Activity 8) is an absolutely necessary basic characteristic for any income generating property, because it puts together income and expenses and shows whether the property really generates net income or in fact it generates net loss. As discussed under Activity 9, net operating income is usually derived from an operating statement, which takes into considerations all revenues and expenses.

Exercise: Tool 1 for performance analysis

Please refer to the sample Operating Statement shown in Activity 7. In that statement, the Net Operating Income is shown as 530. For purposes of this example, let us assume the fair market value of the property is 15,000. (The numbers are for illustration only. They could represent thousands – or any other multiple - of currency unit, for example.)

In this example, the annual capitalization rate is 3.5% (530/15,000), while the interest on bank deposits is 3-7%. Therefore, this hypothetical property generates a return that is close to the low end of the range of the other potential investment – a bank deposit, which also is perhaps associated with a lower risk. Therefore, the investment in this apartment is not attractive because it gives low returns on value and is associated with higher risks than the alternative of putting the same amount – 15,000 – on a bank deposit and accumulating the interest income.

In the referenced example, there is also an interest payment on a mortgage of 90 and a principal payment of 100 as well as overhead expenses of 15, reducing the cash flow to 325. This indicates that the sale of the property at fair market value would not produce 15,000, but some amount less than that reflecting the liability of the mortgage which would either be repaid or assumed by the buyer at the time of sale.

If the interest is 90 and the mortgage principal balance is 900, then the equity is 15,000 less 900, or 14,100. The cash flow is 325 or 2.3% of the equity (325/14,100).

What can be done when an asset manager sees indications that the income generating property does not produce satisfactory returns? First, he or she should scrutinize the entire chain of property management in order to find whether there are overlooked opportunities to improve financial results. In particular to:

INCREASE INCOME through:

• Increasing rent up to a true market level
• Decreasing vacancy time
• Increasing collection rate, and

DECREASE EXPENSES through:

• Saving on maintenance and repair without compromising property value
• Reducing utility expenses
• Minimizing management expenses
• Revising norms for contributions in reserve/replacement funds.
It must be noted that $R$ is dependent on $V$ as well as $I$. If the estimate of value is too high, then $R$ will appear too low. It will seem that the cash flow is too low relative to value, but could be perfectly acceptable if a lower, more accurate, value were to be used. Likewise, if the value is shown too low, $R$ will be more attractive than is justified. So it is important to have objective value data.

Also, the asset manager should have operating statement information, which traces property performance over time, on a regular basis (yearly or monthly or both, depending on the type of property). Having operating statements on a regular basis allows the asset manager to monitor cash flow over time, which enables more comprehensive and instructive analysis of property performance.

**II.9.1. Regional Experience, Croatia: Identifying Under-Performing Rental Properties in Varaždin**

After asset managers in Varaždin identified all properties subject to restitution claims and completed property classification, they identified approximately 70 surplus properties not subject to restitution and used as income-generating rentals. Asset managers estimated the value of each of these surplus properties and compared that value to the net income produced by the respective property. They immediately found many properties that had income far below a minimum threshold of 5%, which indicated that these properties did not generate enough income, comparing to the value that market placed on them.

The outcomes of this analysis in Varaždin were many. Two examples are the improvement of general leasing practices and instituting compulsory competitive bidding procedures for sub-leases at sports facilities managed by sport clubs.

Over a six-year period, the City budget doubled, partially due to increased economic activity in the area, but in large part due to improved asset management.

**Tool 2**

Operating Statements for each property allow asset managers to use simple ratios to compare one property to another within the same category and identify properties, which perform worse or better than others. A frequently used ratio is:

\[
\text{Operating expense ratio} = \frac{\text{Total Operating Expense}}{\text{Effective Gross Income}}
\]

Or complementary to this

\[
\text{Net income ratio} = \frac{\text{Net Operating Income}}{\text{Effective Gross Income}}
\]

Comparisons of line items of income and expense on a “per square meter” basis is also very useful. These ratios may be within different ranges for different types of properties (for example, for residential and business rentals).

**Discounted cash flow analysis**

A more comprehensive technique for analyzing income real property or investment projects is Discounted Cash Flow Analysis. In essence, this technique provides an estimate of the market value of a property or project based on revenues and expenses which are incurred over time. It is especially useful when there is a need to make a financially sound choice among two or more alternative uses of the same property or among alternative investment projects.
Discounted Cash Flow is based on the premise that money is worth more today than if one must wait until a later date to receive it. Simply stated, would you rather be given one million Dinars today or one year from today? Clearly, it is better to receive it today and invest it for a return during the year. So future revenue is worth less than present revenue. The purchase of an asset today (or the decision to not sell it and receive its value today) entitles its owner to receive the cash flow it produces and eventually the proceeds of its sale. The discounted cash flow is today's value of the future flow of revenues from the operation and the eventual sale of the asset. The amount of the discount, a percentage, should reflect returns in the investment market. A higher discount rate means that future revenues are worth less today, while a lower discount rate results in a higher value today. Likewise, revenues further in the future are worth less today than revenues received sooner.

Financial analysis depends very heavily on the use of discounted cash flow techniques. Typically, it is useful to convert all cash flows into net present values using a discount rate to equalize all options. It is possible to find the net present value of a single amount to be received (or paid) at some date in the future, and to find the net present value of a flow of funds, either uniform or unequal, received in a series of payments.

Though this guidebook does not provide systematic instructions on use of the Discounted Cash Flow analysis, we do provide below some examples that illustrate use of this technique in asset management.

**Other Indicators**

Some other indicators are discussed in APPENDIX 5.

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**Example I**

The city owns an unimproved and unused parcel of land and wishes to sell it. A company offers to purchase it and presents two alternative proposals. It will pay 10 million <currency units> to the city immediately, or it will pay future operating costs for keeping the parcel unused (so that the city has no expenses) and will purchase the property in ten years for 20 million <currency units>. It is the opinion of city officials that its cost of capital is 10%. Which proposal should the city accept?

**Answer:**

20 million in 10 years, discounted by 10%, is 7,710,870 today, or less than the 10 million offered for cash today. Given the assumptions, the cash offer of 10 million <currency units> is better.

**Example Ia**

Assume the same example as above with one change. The city is using the plot as a parking lot, which generates the net income of 500,000 <currency units> per year. The purchaser offers to pay 500,000 <currency units> per year to the city for ten years and will then purchase the property for 20 million <currency units>. Which proposal should the city accept?

**Answer:**
The 7,710,870 net present value of the 20 million discounted over 10 years at 10% remains, but we need to add the net present value of the 500,000/year. The net present value of that flow of cash is 3,072,280. The total of the net present value of the later sale price and the cash flow in the intervening years is therefore 10,783,150, more than the 10 million cash offered today.

Example II

Two properties are being analyzed. It is expected that both will be sold in 10 years for the same price. During the ten years, both will produce the same amount of rental income, but at different times. Which property is more valuable today?

<table>
<thead>
<tr>
<th>Year</th>
<th>Property 1</th>
<th>Property 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1,000,000</td>
<td>5,000,000</td>
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<tr>
<td>2</td>
<td>1,000,000</td>
<td>5,000,000</td>
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<tr>
<td>3</td>
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<td>5</td>
<td>1,000,000</td>
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<td>6</td>
<td>5,000,000</td>
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<td>5,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>10</td>
<td>5,000,000</td>
<td>1,000,000</td>
</tr>
</tbody>
</table>

Answer:

Property 1 has higher cash flows later in the time period of ten years, while Property 2 has higher cash flows earlier, although each has total cash flow of 30 million <currency units>. It is always better to get money earlier than later. The difference in value depends on the discount rate used, but in each case Property 1 will be worth less because of the timing of the receipt of the larger sums.

Example III

The city owns a property (land with building) that is unoccupied and in need of repair. The city received two offers:

- One company proposes to lease the property for 25 years for annual rent of 10,020,000 <currency units> per year, provided that certain improvements are made to the property so that it can be used efficiently and comfortably. The company offers to lend the money to improve the property. It estimates the cost of improvements at 80 million <currency units> which it will lend to the city at an interest rate of 12% to be repaid over 25 years.

- A second company has offered to purchase the property in its present dilapidated condition for 10,000,000 <currency units>.

Which is the better offer to the city? Why?

Answer:
In the deal with the first company, the mortgage payment costs will be 10,020,000 <currency units>/year, equal to the rent. Therefore the city will receive no cash flow for 25 years. At the end of 25 years, the value of the improvements will be reduced by 25 years of usage and deterioration. Even if the property retains significant value from the improvements, it will be 25 years before a new lease or sale of the property will produce value, and the net present value of anything 25 years from now is limited. With the information provided, one must make assumptions for further analysis.

Let's now consider very optimistic assumptions about the first offer: that the property in 25 years will be worth 90,000,000 <currency units>. This is based on the assumption that the property “as-is” today is 10 million <currency units> and that this value remains unchanged over 25 years, and that the improvements of 80 million will completely hold their value without any deterioration or depreciation over 25 years. Further, let's assume that the city requires a return of 15%. No inflation is assumed. Under such assumptions, should the city sell immediately for 10 million <currency units> or lease for 25 years as described?

The net present value of 90 million <currency units> 25 years from now discounted at 15% is 2,733,990 <currency units>, less than the 10 million offered in its "as is" condition. The 10 million cash offer is better.

---

**Example IV**

A property is appraised at 2,000,000 <currency units> and produces annual net income of 600,000 <currency units>. Is this a good investment?

**Answer:**

This is 30%! That is very good. But are all the costs of holding the investment accounted for? Operating an asset management department is costly, and each asset must be monitored. If, for example, the cost per property for asset management (oversight) is 500,000 <currency units>, this becomes a poor investment. We must look deeper than simply the property return.

---

**Example V**

What are the elements of the interest rate?

**Answer:**

Riskless rate of return (safest possible investment)
Inflation
Tax cost
Credit risk
Operational risk
Other risks (currency, etc.)
Perhaps others!
II.10. Activity 10: Deregulation of Business Rentals and Improvements of Rental Practices

Recommendations for implementation:

- Revisit and revise the Local Government Ordinance and/or other documents regulating the use of the local government’s rental business premises
- Clarify which business premises are controlled by the Municipality and centralize business leasing premises into one entity
- Improve bidding procedures and the standard lease agreement in order to ensure better marketability and profitability of local government’s business rentals
- Revise management of rental properties, both business and residential, to systematically improve overall efficiency (in particular, to be able to monitor financial performance of all rental properties and portfolios, increase collection rate, decrease management costs, etc.)
- Put servicing of the housing loan portfolio on an open competition, and encourage banks to participate.

Deregulation

The policy and practice of leasing business premises in local governments should be aligned with common approaches in countries with a developed market economy. Specifically, there are countries where this sector in local governments appears to be unnecessarily over-regulated, with mostly negative consequences for the local government economy. Over-regulation can take place along several lines.

Some local governments define the type of property use in too much detail. Thus, when property is offered for competition, it has its permitted use prescribed too narrowly as “retail” or “catering business” or “office,” etc. In cities with market economies, the decisions whether to place a retail shop, or catering service, or any other every-day or specialized service, or even an office in any specific location is left to private entrepreneurs who are running all these services and compete with each other for getting settled at specific locations based on demand signals. Zoning regulations place broad restrictions on use, but within those restrictions there is wide flexibility allowing, for example, clothing sales, restaurant, electronics repair, or a barbershop in a “retail” space. It has been proven many times around the world that private sector vendors have a much better sense of what people might need in a specific location than any government might have. When government decides how a real property unit should be used, it creates artificial spatial patterns and makes services less convenient than in case when the government let the private sector decide.

Distortions resulting from such “planned allocation” of real property are notable. Also, any additional limitation imposed on property use lowers potential income and hence lowers property value, which the owner may obtain through lease or sale of the property. Further, those limitations tend to increase vacancy and lead to deterioration in the condition and appearance of the property and the surrounding area.
Consolidation and centralization of business premises management

There are two tasks here that should be addressed concurrently. First, management of commercial rentals should be consolidated at a single entity, instead of common practice when partial management responsibilities are spread among two or three, sometimes even four municipal departments or enterprises. Management of rental portfolio should include all functions and activities (advertising, conducting leasing procurement, preparing and signing leases, maintaining lease database, monitoring payments, enforcing contract compliance, etc.).

Second, it can be useful to include into this consolidated management leasing / renting premises that are not considered “commercial rentals” but are still rented out by various municipal institutions and enterprises in “their” buildings (such as theaters or cultural centers). However, for maintaining interest and incentives for these entities to identify and rent out surplus space, they should receive some share of rental revenues (sometimes it is shared 50/50 between the municipal budget and the institution).

Why is this consolidation of the renting activities important? Because when municipal institutions or enterprises are renting out their surplus space themselves, this usually leads to various inefficiencies and very non-transparent revenue flows. For example, quite often, they lease premises without competitions, thus obtaining less revenue than they could.

As the very minimum, if these institutions / enterprises would continue renting out themselves, they should be obliged to (i) follow up competitive procedures established for the general portfolio of commercial rentals, and (ii) transparently and regularly report all their revenues and expenses related to the rentals.

Improving rental practices

Critical areas of improvement of performance of rental properties controlled by local governments may include: Improving leasing procedures and contracts, increasing the rent collection rate, and reducing operating and management costs.

- Improving leasing procedures and contracts

A municipality has the power to impose limitations and requirements on property use and related transactions. It is more difficult to give decision-making power to tenants and buyers. Yet this must be done as much as possible. Certainly society has interests that must be protected through restrictions and other mandates. But excessive regulation and restrictions will drive away those who may have a more productive use for property and who can therefore pay a higher price or rent. It is important to review lease forms and practices, sale procedures, use restrictions, and anything else relating to the private use of city assets and strive to eliminate every requirement not essential to the public’s interest so that the economic benefit of the city’s assets can be maximized.

For increasing the efficiency of local governments' rental practice, it also would be useful to improve lease contracts and leasing procedures.

1. In some countries, tenants of the local governments' premises have indefinite period leases. This practice should end. Instead, all leases should be for a definite period of time. However, a lease contract may include a provision that if a tenant wants to extend the definite period lease, he or she should notify a landlord in writing at least 3 months before a lease expiration date. The landlord may than agree to negotiate with the tenant a new lease before the expiration date. The number of renewal options (terms of months or years) should be limited.
2. All lease contracts should stipulate that the landlord has the right of adjusting rent at the moment when the contract extension is negotiated. The tenant would not be able to occupy the space indefinitely without paying increased rent when market prices rise substantially. A common arrangement in commercial leases is that at the moment of lease extension for a new term, rent is revised and brought to the market level (usually, to 95% of a market rent in order to create an incentive for the tenant to continue to stay at the premises and to recognize the importance to the owner of uninterrupted cash flow through continued occupancy). Another approach is to increase the rent in proportion to an inflation index.

3. All leasing out should go through open public tenders (auctions or “sealed bid competition”). The purpose of the competition should be to increase the monthly rent (and not one-time payment), so the winner should be a bidder offering the highest monthly rent. Starting prices in these tenders should approximate the prices on the private rental market.

4. The local governments should give at least 30 days from publishing an advertisement of available premises until the deadline for applications. Shorter periods between publishing and the deadline are not sufficient to allow prospective tenants to consider their participation in the bid.

5. There are important rules that can be extracted from international experiences of conducting this kind of public tender:

   o The terms of the offering should be clearly stated in the announcement or information package easily available to potential bidders. It should describe the premises, the term of the lease in years or months, the starting monthly rent (below which the municipality would not rent the premises out), the party responsible for operating expenses and capital expenses including preparing the space for occupancy, and other relevant factors.

   o It is preferable to conduct open oral auctions instead of sealed-bid competition

   o If, nevertheless, this is a sealed-bid competition, offers (bids) should be accepted until the stated time of public opening the envelopes; following this rule prevent a corrupt practice of illegal opening of envelopes by corrupt officials and leaking prices to their co-conspirators who then file offers with a better price.

   o The bids should be opened and read in the presence of all applicants who care to attend the bid opening, with prices offered announced, along with the highest winning price pronounced immediately (though formal notification to the winner can be sent later). Similar, on the oral auctions, the winner should be announced immediately.
Increasing collection rate

By commercial market standards, the collection rate at local government rentals should be improved in most cases (see also APPENDIX 5). Local government asset managers should investigate reasons for low collection rates and take actions for removing these reasons and increasing collection. Procedures must be made to enforce the provisions of leases, including the eviction of tenants who do not pay the rent.

Reducing operating costs

Keeping total operating expenses associated with all local government assets under control and scrutiny should be among the key tasks of local government asset managers. As already mentioned, in many cases the total costs for operating property portfolios are not known, partly because the function itself is split among several management entities. In the private sector, property owners engage private real estate management firms to provide partial management service for asset portfolios. Better services and lower costs obtained when management firms have to compete for management contracts and if they are required to provide property services at the lowest possible price. This would be applicable to property portfolios owned by government as well and implies outsourcing some of management functions to the private sector.

The Case of Sport Facilities

Sport facilities represent an important case, and some specifics of managing this portfolio are discussed in Annex 6.
Things to think about:

Why is a transparent tendering system important?

In your municipality, are there restrictions on the use of property that limit the potential rent?

What are the purposes of regulatory limitations on property use?

Which entities are involved in leasing municipal commercial rentals in your municipality?

How the number of these entities could be reduced and who should manage commercial rentals?

II.11. Activity 11: Quantifying and Monitoring of Direct and Indirect Property-Related Subsidies Obtained by Tenants and Users of Local Government Real Estate

Recommendations for implementation:

- Monitor rental prices in the private sector in order to estimate indirect rental subsidies obtained by tenants of local government’s premises

- Sort out which properties are associated with various types of local government support (such as below-market rent, monetary subsidies to tenants for operating expenses or direct payment of operating expenses by the local government, etc.)

- Monitor and evaluate amount of these subsidies for each property and each property portfolio, beginning from properties occupied by NGOs, regular business rentals, sport facilities, and cultural facilities.

When property is rented for the most desirable use according to market demand (subject, of course, to broadly defined zoning limitations), it generates the highest income and value to the owner. Indeed, the successful identification by an entrepreneur of a demand for particular goods or services in a particular location will lead to greater sales and profits by that entrepreneur. Those profits will support the payment of higher rent. Thus, the best use of the property will provide for the highest rent and value for the owner. Of course, mistakes are made and businesses fail. But with multiple rental properties (private and government-owned) and tenants, this process as a whole leads to the best provision of goods and services to the community and the best financial results for all in the long term. Those mistakes and failures must be allowed for the market to function most effectively.

II.11.1. Practical Implication: Indirect Subsidies in Municipal Tenants in Serbia

Under current practice in Serbia, some local governments often pre-determine the use (type of business) for particular rental properties or premises and set rental rates accordingly. For example, the city can be divided into price zones, and within each zone, starting prices are differentiated further (and quite strongly) depending on the type of permitted use and type or legal status of a tenant. For example, a private doctor might obtain premises for lower rent than a barber; or, if someone were running a private art gallery, he or she would compete for local government’s premises with a starting rent up to several times higher than if the same activity – art gallery – were registered as a public institution. As a result, many tenants pay less than they would pay for comparable property on the private rental market or if this same property were rented out without these artificial restrictions on use and users. Under this practice, the local government forgoes potential income, which could be earned by leasing premises at market prices. Further, price control and artificial differentiation of rental rates create distortions to the economy because they provide unfair competitive advantages to tenants who pay below-market rent. Why, for example, is the private art gallery competing in the market at a serious and unfair disadvantage by having to pay higher rent than the gallery registered as a public institution?
The income that the local government forgoes by renting property for below-market rent constitutes the indirect property-related subsidy that tenants of such premises obtain from the government.

The total amount of forgone income is difficult to estimate without special monitoring. However, partial estimates in several municipalities in the Balkan countries indicated that the forgone annual income from such subsidies was at least 0.5% - 1.0% of the total municipal budget.

Typical receivers of indirect rental subsidies are not-for-profit organizations. There can be premises allocated to them, with substantial total floor area and located in the most prestigious and expensive zones in the historic or business centers. In some cases, not-for-profit organizations pay symbolic rent, which may be dozens of times below market, and the indirect rental subsidies to them can be 35 UERO per square meter annually, and more.

## II.11.2. Regional Experience, Croatia

### Indirect Subsidies in Varaždin, Croatia (before asset management improvements)

The City of Varaždin had identified indirect annual subsidies to NGO of about 500,000 Kuna as shown in the chart below.

![Chart showing current and potential monthly rent]

A decision on whether indirect rental subsidies (and of what size) should be provided to tenants occupying a local government's non-residential premises is completely political. However, decision-makers should be well informed about the costs of the subsidies, and supplying them with this information should be the responsibility of the local government's
asset managers. In particular, for each premise, asset managers should know at least the estimated market rent; then the size of the subsidy can be estimated for each premise as:

\[
\text{Indirect rental subsidy} = (\text{Market rent}) - (\text{Actual rent})
\]

Calculations demonstrating the size of a subsidy received by subsidized organizations because of discounted rent should be monitored by using the following chart.

<table>
<thead>
<tr>
<th>Tenants</th>
<th>Address</th>
<th>Area (m2)</th>
<th>Actual Rent</th>
<th>Market rent</th>
<th>Difference = Indirect subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
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<tr>
<td>TOTAL</td>
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</tbody>
</table>

If reduction of these subsidies is established as a goal, the way to achieve it is obvious: premises with subsidized rents should be those where market rents are the lowest; in other words, the most modest premises (in the sense of both quality and location). In particular, the prestigious areas should not be the home for subsidized premises.

In sum, revising existing policy and practice can lead to more fair economic conditions for tenants of municipal rentals, more revenues to municipal budgets, and greater transparency about who receives public subsidies (direct or indirect) and how much.

II.11.3. Regional Experience, Croatia: Managing Premises for NGOs in Varaždin, Croatia

Varaždin has relocated NGOs from prime space to the reconstructed military compound. Their use of space is being further rationalized so that, where possible, NGOs share space under “time share leases” (by using the same premises on different days). Also, leasing practices are being revised to provide more direct subsidies and less indirect subsidies. As a result, the number of non-governmental organizations that were provided with space increased from 37 to 51; the City’s revenues from these premises increased by 40 percent; at the same time, the City leased through auctions the attractive business premises that NGOs previously used, obtaining HRK 100 million of additional annual revenues.

In addition, subsidies to sports clubs were analyzed and contractual agreements with the clubs changed on a large scale, reducing municipal expenses on maintenance of sport facilities.

Things to think about:

What practices at your municipality reduce potential income from rental properties?

How can those practices be changed to reduce indirect subsidies and increase revenues?

How should the municipality decide which entities are deserving of indirect subsidies?
Why are good management practices important in managing NGOs?

What private businesses (if any) are deserving of indirect support in the form of reduced rent?

How does use restriction help the favored user and hurt other potential users?

---

II.12. Activity 12: Reporting on Property

Recommendation for implementation:

- *Introduce and test a format for an annual report on local government property assets as a high priority task, and than improve it gradually over time.*

Local governments and their residents need full and concise information about the property that the local government owns and supports. Mayors, Councils, and residents do not necessarily have to be interested in detailed information on each property item. However, they need to have a clear summary review showing the main property portfolios, related revenue, expenses, and key entities involved. The level of information should be sufficient to assure the public of the integrity of the management of these assets to eliminate the suspicion of corruption in the allocation of local government properties and other financial and non-financial aspects.

Cities have not agreed on a standard form of reporting, and both those preparing the reports and those receiving them should either agree that the format and content are acceptable or reach agreement on appropriate changes. The report should provide enough information to meet the needs of the public, but Asset Management personnel should not be burdened with presenting unnecessarily detailed information.

II.12.1. Regional Experience, Croatia: Reporting on Property in Varaždin

In late 2002, the City of Varaždin, with assistance of the Urban Institute, adopted a reporting format and has used it to present asset management issues to the City Government and Council. Due to this report, the City Government and the Council have an opportunity to review all of the real property of the City of Varaždin, as well as all of the relevant, related management decisions, in consistent and cohesive form.

The report can be divided into a narrative, summary section, and detailed section. The narrative section provides an overview of the performance of the assets under management and the economic environment in which they are being managed. The summary section provides data on the portfolios of similar properties such as government-occupied property (i.e., City Hall), types of surplus properties, social housing, etc. It should include ALL properties under control of the local government, including properties managed by municipal enterprises and various local public institutions (cultural social, etc.). The detailed section includes a report on each property including physical and financial data.
If a property is leased to private tenants at market rental rates, it is not important to know the details of their operations beyond that information needed to assure their compliance with the terms of the lease.

If, however, the tenant is subsidized, that tenant should provide complete detailed financial information including expenses incurred in connection with their operation of the property as well as revenues generated from all sources by the tenant.

Appendix 4 contains a sample format for a property report. In the future, such a report may become a part of the overall financial reporting at the local government, and should be treated as a component of a consolidated reporting system. This document should be easily available to citizens.


There are two key rules regarding reporting:

- Reporting should provide all, but only, the information necessary for those receiving the report.
- The creation of the report, especially an elaborate report, is not the goal. The goal is to enable decision makers to be well informed so they can make good decisions and to allow other stakeholders, such as the public, to be confident those decisions are made intelligently and with integrity. If unnecessary information is being wastefully provided, or important information is not included, then the report should be modified. There is no other rule, and there is no magic formula for the perfect report.

**II.12.3. Practical Implication: When Is It the Time to Introduce Reporting in Municipalities?**

Introducing the reporting on property is not an easy task, because it requires certain information and knowledge about the properties, while this information not always exists. However, it is a big mistake not to start reporting until data would exist. Even incomplete at the first attempt, the report and the process of its preparation will be very helpful to both asset managers and decision makers because it will show them which of desirable information is not easily available or doesn’t exist at all. This would help identify the directions of improvements and would help have a more complete report the next year.

**Things to think about:**

Why is reporting necessary?

Who should receive, or have access to, the report.

What is the initial set of information that you would suggest for the asset report?

**II.13. Activity 13: Management Consolidation**
Recommendations for implementation:

- **Centralize the management of all real estate in one department or office or at least introduce unified rules for asset-managing departments**

- **Use existing services (such as accounting) provided by other departments of the local governments as extensively as possible so that services do not have to be duplicated**

- **Identify all components of asset and property management where competitive outsourcing to the private sector would result in higher efficiency, and begin the systematic use of outside contractors chosen competitively**

- **Introduce financial incentives for the asset management staff**

Asset management, with few exceptions, often is too much fragmented and split among several managing entities (municipal departments, institutions, enterprises, while none of them has a full picture of the situation. Organizationally, asset management in local governments may be improved in at least two ways.

The first is to organize a central asset management department that is responsible for development and implementation of the strategy, programs, and specific actions regarding local government property holdings. Among routine obligations of this department, the most pressing is to organize the tracking of all information that is needed for prudent asset management, including financial information about properties and portfolios. The department also should develop plans for improving the financial performance of individual assets and portfolios and prepare regular reports on local government property holdings and their performance.

The second is to introduce the rational use of outside contractors. Outsourcing a number of functions associated with asset management is widely used in many countries. This may include integral functions, such as property management and maintenance at the level of specific properties (for example, a separate sport facility) or whole portfolios (such as the portfolio of residential properties), or just specialized functions (accounting, cleaning, etc.). The key is that any outsourcing should be conducted through transparent and truly competitive procedures, with full accountability of contractors and vendors for the results.

Centralizing responsibility is very important. One department and its personnel must be directly and entirely responsible for the assets and must be held accountable for all aspects of their financial performance and the preservation and enhancement of their value. They must have the authority to outsource various necessary functions and to enforce the terms of the outsource contracts so that, if a function is not being performed in a satisfactory manner at a reasonable cost as agreed, the contract can be terminated and another contractor retained. Centralized control is important for communications as well. For example, a rent collection problem may be related to deficient maintenance and repair of the property. The tenant may withhold rent because the roof is leaking. The manager must be able to enforce both the collection of rent and the repair of the roof.

A staff of three or four highly qualified asset managers with administrative or clerical support should be capable of handling a portfolio of approximately 225 properties. Responsibilities for each property may include retaining a property management firm, overseeing the work of that firm, and reviewing and approving annual budgets prepared for each property by the property management firm. Further, the asset manager would be responsible for monitoring maintenance, developing capital improvement plans, recommending the sale of surplus
properties and executing approved sales, reviewing monthly income statements for each property, assuring that the property management firm is effectively collecting all rents, and other related activities. A threshold level of authority should be established specifying a number of Dinars under which the department can make decisions regarding capital transactions and over which the decision should be approved by the Local Government Council or its designated committee.

This office should use existing local government and private services as extensively as possible. For example, various departments or municipal enterprises would continue to provide certain services at the direction and under the supervision of the asset management department. Independent contractors may be retained for property management, appraisal, brokerage, and other services.

Local government staff may retain property management responsibility for some properties such as City Hall, kindergartens, and social housing. However, many cities and other governments have found it beneficial to retain independent property management firms to manage these assets as well, primarily to assure good management at a low cost, i.e. for the reasons similar to ones for outsourcing municipal services.

The asset management department would be responsible for maintaining all information about each asset owned or controlled by the local government. It would report annually to the Local Government Council on the condition and performance of each asset in a summary format.

It may be helpful to review a summary of respective responsibilities of the asset manager and the property manager:

**Asset Manager**

- Complete oversight of the assets
- Maintenance of records of each asset
- Selection and supervision of a property management firm (property manager)
- Review of the financial performance of each asset
- Monitoring the monthly remittance of cash flow from the property manager
- Ordering and review of appraisals (and documenting the estimates by the asset manager of the value of smaller properties)
- Planning for and executing capital improvements
- Approval of rental rates and participation in the negotiations of major leases
- Recommending sale or retention of the asset
- Assuring that each property is insured appropriately
- Assuring that taxes are paid
- Annual formal review of each asset
- Evaluation of the performance of the property management firm
- Periodic inspections (at least annually) to assure appropriate physical maintenance
- Other functions as necessary to assure the optimum performance of the asset and the preservation of its value

**Property Manager (Private Property Management Company)**

- Acting as agent for and on behalf of the owner in supervising the day to day operations of property, with full loyalty to the owner
- Finding tenants to lease the premises
• Assisting the Asset Manager in negotiating large leases
• Signing leases for smaller tenants according to an approved lease form and rental rate
• Collecting rents
• Paying expenses from collected rents or from funds provided by the Asset Manager
• Remitting the net cash flow to the owner (asset management department) each month
• Arranging for necessary services provided by independent contractors such as painters, carpenters, roofing contractors, and others, and assuring that their work is of good quality
• Preparing monthly and annual financial reports for each property
• Proposing annual budgets for approval by the Asset Manager
• Conducting regular inspections to assure good maintenance
• Other functions as directed by the Asset Manager

Things to think about:

Why is consolidation of asset management within the Local Government important?

What are the key differences between asset managers and property managers?

Recall the difference between maintenance and management.


Recommendations for implementation:

• Develop a Comprehensive Plan for asset management, including priorities of tasks
• Obtain approval of the Comprehensive Plan by the Local Council
• Ensure implementation of the Comprehensive Plan according to the developed schedule

Local governments could benefit from applying international experience, which has demonstrated that a Comprehensive Plan for Asset Management is a powerful instrument for advancing in this area. The Comprehensive Plan allows the development and implementation of long-term policies and justifies actions in this regard.

The Comprehensive Plan should answer important policy questions, such as:

• How many properties local governments must own or support for providing their mandatory functions and supporting social programs
• How should social goals of property ownership be balanced with financial circumstances of the local governments? In particular, how big should direct and indirect property-related subsidies to various tenants be?

• What should be the policy regarding surplus property owned by the local governments?

• In what situations should the local governments get involved in business enterprises? How much may they invest in businesses? What is their risk tolerance regarding business involvement? Should a government enterprise compete with private entities in the same business?

It is particularly important to reflect in the Comprehensive Plan that local government asset management includes a much wider range of issues than those that were until recently dealt with by various local government departments. Asset management is not only assurance of operational maintenance and repair of municipal real property but also making economically and socially justified decisions on property reallocation, change of use, and disposal. It also should address complex questions of local government business activities and involvement in the ownership of various enterprises. A number of decisions will address the question of sorting out how various specific properties should be used (for obligatory functions, for voluntary subsidized social functions, and for income generating through “highest and best” use).

The Comprehensive Plan should include several key sections:

1. Formulation of goals and principles of the local governments' asset management.

2. Commitment to full inventory and accounting of all properties for asset management purposes.

3. Classification of all real property items by the three functional groups (mandatory, discretionary and income generating, as defined under Activity 3) and formulation of financial goals and management strategy for each group.

4. Identification of the local governments' regulations that require some change for improving asset management, and recommendations on these changes (for example, liberalization of the local governments' ordinances regulating business rentals).

5. A list of specific actions for the groups of properties and for separate properties, whenever it is necessary (such as change of tenants or managers, intensification of use, disposal, etc).

6. Suggested organizational changes in asset management, if needed.

7. A realistic mechanism and schedule of implementation of the local governments' asset management Comprehensive Plan that would reflect local governments' priorities.

After the Comprehensive Plan is developed and approved, the local government should review it periodically to measure progress, assure its continued relevance, and update as necessary.
The development and approval of the Comprehensive Plan, however, is not a reason to delay beginning the implementation of good asset management practices. Data can be gathered and organized, and sound asset management decisions can be made within the context of existing laws and regulations.

**Things to think about:**

Why is a Comprehensive Plan important?

What issues should a Comprehensive Plan address?

Why should a Comprehensive Plan be reviewed periodically?

What activities can proceed before a Comprehensive Plan is prepared?

What decisions should await the preparation of a Comprehensive Plan?
APPENDIX 1: Glossary

Acquisition
The purchase or taking of an asset from another owner, assuming all the rights of the former owner.

Appraisal
An opinion of Market Value. An appraisal is not a determining or fixing of value but is an estimate in the absence of an actual sale. “Appraisal” also refers to the process of appraising.

Appraiser
A person who prepares Appraisals. While anyone can appraise, a professional appraiser has experience and education in the process of estimating value and has no personal interest in the property or the results of the appraisal process.

Asset
An item of monetary value.

Asset Manager
An agent (representative) of a property owner who is responsible for preparing and implementing decisions on acquisition, holding (and managing) and disposition of properties in the real property portfolio, for achieving goals established by the owner. Activities include strategic planning, financial analysis, analysis of property operations, decisions regarding Capital Improvements, and oversight of the performance of the Property Manager.

Bookkeeping Value of Real Property
The value recorded on the balance sheet (or a similar accounting / reporting document) of a property owner or property holder. Rules and standards for defining bookkeeping value differ for the public and private sector in most countries, though converging over the past years. In most countries where governments have balance sheets to record real property, it is common to define bookkeeping value as a historic cost (i.e. the cost of construction or acquisition) plus the cost of capital improvements minus accumulated depreciation. However, a worldwide trend, encouraged by international accounting organizations (IFAC) and financial institutions (IMF) and already implemented by some countries, is to revalue the property assets based on their market value.

Broker
A person acting as an intermediary between a buyer and seller (or owner and tenant) in the negotiation of a sale (or lease), or an agent representing or assisting one of those parties in the negotiation.

Capital Improvements
Additions to a Real Property Unit that add value through extending its economic life, increasing its potential rental income, reducing its operating expenses, or improving the comfort of its occupants. Examples include replacement of the roof, installation of energy-conserving components such as insulation or improved heating equipment, and adding space to the building. Excluded are items such as fuel, roof repairs, painting, and other routine Maintenance and Repairs.

Cash Flow
For purposes of this text, the periodic income associated with the ownership or control of a Real Property Unit. Cash Flow in this context does not include the profits from operating a business in the property. Cash Flow is customarily positive, but may be negative as in the case of a property with no occupants, property devoted to a Social Function, or property used for a Core Function such as City Hall. Net Operating Income may differ from Cash Flow to the extent of mortgage payments and other transactions associated with the Real Property Unit but not resulting from its operations.

**Core Function**
For Real Property, a use that is essential to the performance of the central role of the owner. Examples include city hall serving a core function of a city and classrooms serving a core function of a school.

**Cost Approach (to Property Appraisal)**
The process for arriving at a value indication by estimating the current cost (including profit) to construct a reproduction of an improvement, deducting accumulated Depreciation, and adding the market value of the land. This is one of three approaches that may be useful in estimating Market Value, the others being the Sales Comparison Approach and the Income Capitalization Approach.

**Depreciation**
This term has two meanings. In the context of Bookkeeping Value, it is an annual bookkeeping expense according to a formula to recognize the inevitable fact that Improvements (not land) have a finite life and will eventually become worthless. In a physical sense, it is any loss of value, perhaps due to physical deterioration or obsolescence due to changed occupant requirements.

**Discounted Cash Flow (analysis)**
The process of estimating the value today of future periodic cash flows (net present value). Those cash flows may include annual net operating income and the eventual cash received from the sale of the asset. They are reduced by a market-based rate reflecting returns of similar assets and by the elapsed time until they are received. The value of an asset today is equal to the sum of all the discounted future cash flows.

**Disposition**
Sale, restitution, donation, or other transfer of all rights to an Asset to a subsequent owner.

**Effective Gross Income**
Gross potential income less income lost to vacancy. Generally, this is the total rental revenue actually received.

**Fixed Asset**
An item of monetary value that is of a long term nature. Examples include Real Property, equipment, components of utility systems, and streets. Cash, accounts receivable, and consumable items such as office supplies and fuel are not fixed assets.

**Improvements**
The general term describing all relatively permanent additions to land. Examples include buildings, paved parking, connections to utility systems (such as water, sewer, and electricity), and fences.
Income Capitalization Approach (to Property Appraisal)
The process for arriving at a value indication by (a) estimating Cash Flow and dividing it by a market-based rate of return or (b) finding the net present value of estimated future cash flows from income and the eventual sale of the property using a market-based discount rate. (See Discounted Cash Flow.) This is one of three approaches that may be useful in estimating Market Value, the others being the Sales Comparison Approach and the Cost Approach.

Indirect vs. Direct Subsidies
Direct subsidies are grants of cash to the recipient. Indirect subsidies are benefits given in the form of reduced rents, the use of facilities in a location or of a quality better than required for the recipient’s functions, or other non-cash benefits.

Life Cycle Cost
The total cost of owning, operating, and maintaining a Real Property Unit over its useful life.

Maintenance and Repair
Keeping a Real Property Unit in condition to perform its function and sustain its value by replacing deteriorated or damaged components. Maintenance and Repair do not increase Bookkeeping Value but prevent deterioration. This process should not be confused with Property Management.

Management
See Property Management.

Market Value
The most probable price which a specified interest in real property is likely to bring under all of the following conditions:
1. A sale occurs as of a specified date.
2. An open and competitive market exists for the property interest appraised.
3. The buyer and seller are each acting prudently and knowledgeably.
4. The price is not affected by undue stimulus.
5. The buyer and seller are typically motivated.
6. Both parties are acting in what they consider their best interest.
7. Marketing efforts were adequate and a reasonable time was allowed for exposure in the open market.
8. Payment was made in cash or in terms of financial arrangements comparable thereto.
9. The price represents the normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Multiple (Mixed) Use
A combination of different but compatible uses of various Premises within a Real Property Unit. An example is a building with retail stores on the ground floors and residential apartments or offices in the upper floors.

This definition is used in the U.S. and Canada, and varies slightly in the International Valuation Standards Committee’s (IVSC) and other countries’ definitions (as the term may vary in some countries as well). However, all key components of the above definition are common for countries with developed and emerging markets.
Net Income Ratio
Net Operating Income divided by Effective Gross Income, usually expressed as a percentage.

Net Operating Income
Revenues from operating the Real Property Unit (typically rent) less expenses associated with operating it. Expenditures for Capital Improvements and for making mortgage payments are not considered in the calculation of Net Operating Income.

Non-Traditional Role of Government
The performance by government of functions not essential to the safety and health of the public and which are or could be available from the private sector. Examples are the providing of housing and entertainment.

Operating Expense Ratio
Operating expenses divided by Effective Gross Income, usually expressed as a percentage.

Operating Statement
A financial statement showing all revenues and expenses associated with the operation of a Real Property Unit over a certain period of time. Shows gross revenues and expenses by categories (such as administration, Maintenance and Repairs, electricity, taxes, etc.). An Operating Statement should include the categories necessary to accurately reflect the financial performance of the operation the Asset. The Operating Statement shows Net Operating Income.

Premises
The space such as one apartment or one store/retail space within a property occupied or suitable for occupancy by a single tenant. A Real Property Unit may include one or more premises.

Property
Throughout the text is used as a short version for Real Property Unit.

Property Level Accounting
A record of all of the revenue and expenses associated with or attributed to a Real Property Unit.

Property Management
The process of maintaining and creating value through maximizing revenue, controlling expenses, managing risks, complying with regulatory requirements, and assuring the proper physical maintenance of the property and accommodation of tenants. This function should not be confused with Maintenance and Repair.

Property Manager
The person or company acting for and at the direction of the property owner in fulfilling the Property Management function.

Public-Private Partnership (PPP)
An umbrella term used for many forms of private sector involvement in the provision of traditionally public sector services. PPPs can take the form of management contracts, leases, concessions, BOTs (build/operate/transfer), or more complex deals, for example those that include sale/lease-back arrangements.

Real Property (equivalent to Real Estate, except in U.S.)
Physical land and permanent improvements such as buildings and paving and the legal rights associated with physical property. In the U.S., a subtle distinction is made between real estate (physical asset) and real property (the legal rights associated with the physical asset).

**Real Property Portfolio**
The Real Property Units owned or controlled by an entity such as a city. A portfolio may consist of all Real Property Units or a subset such as all social apartments, all surplus real property units, or properties suitable for use as a retail store. Such a subset may also be defined geographically, such as within the central city. A subset as a portfolio may be defined in a way that meets specific needs including financial analysis.

**Real Property Unit (Unit of Immovable Property)**
A distinct and separate asset consisting of land and its physical improvements or, in the case of multiple owners of discrete spaces within a single building, the space within the building owned by a single owner. A real property unit may contain one or more premises.

**Rent**
Payment of money by a tenant to the owner of a Real Property Unit for the exclusive right to occupy and use specific Premises.

**Rent Collector**
An agent (representative) of a Real Property owner who, on behalf of the owner, receives Rent from tenants and remits it to the owner. The rent collector may take action to enforce collection or to evict a tenant who fails to pay the Rent when due.

**Restitution**
In general, a restoration of something to its rightful owner or a legal action serving to cause restoration of a previous state. In former socialist countries, restitution is commonly associated with restoring ownership rights of property owners from whom real estate was nationalized (or providing them with some compensation).

**Sales Comparison Approach (to Property Appraisal)**
The process for arriving at a value indication by comparing the Real Property Unit being appraised (“subject property”) to similar Real Property Units for which recent sale data are available and making adjustments for differences between the subject Real Property Unit and the comparable Real Property Units. This is one of three approaches that may be useful in estimating Market Value, the others being the Cost Approach and the Income Capitalization Approach.

**Sealed Bid Competition**
The process of selecting a buyer, tenant, or vendor by inviting all interested parties to secretly submit an offer (bid) in a sealed envelope no later than a certain date and time. The bids are then opened in the presence of all bidders so they can observe that the winner is selected based solely on the bid rather than on other factors such as corruption. The public may be invited to observe.

**Social Function**
For Real Property, a use that is viewed as beneficial to the community but not essential to the performance of the central role of the owner. An example includes housing provided to low income or elderly citizens for an amount of Rent that is less than that which could be obtained in the open market.
Social Tenant
An occupant of housing Premises who is given the benefit of occupancy at a Rent that is below that which would be paid in the open market because of personal circumstances such as low income or advanced age.

Traditional Role of Government
The performance by government of those essential functions which cannot be performed by private citizens. Some of these functions are national defense, police and fire protection, highway and utility systems, public health, and courts of justice.

(The) Triangle Formula
The formula involving income (I), capitalization rate (rate of return) (R), and value (V). If any two of these components are Known, the third can be determined.
\[ R = \frac{I}{V} \]
\[ I = R \times V \]
\[ V = \frac{I}{R} \]

Use
Occupancy of a Real Property Unit and the benefits and obligations related to that occupancy. More specifically, a particular type of occupancy such as residential, manufacturing, office, etc.

Valuation
Appraisal

Note: The Dictionary of Real Estate Appraisal, published by the Appraisal Institute, is an extensive review of real estate terminology. The Appraisal Institute is an excellent source of technical literature on the subject of real estate appraisal and readers are encouraged to refer to its resources. See its website at www.appraisalinstitute.org.
APPENDIX 2: Local Government Asset Inventory Guide

Note of Caution

As mentioned in chapter II.2 of the main text, this Guidebook is not dealing with information technology issues of inventorying municipal property. Nevertheless, we assume that users of this Guidebook most probably would start from accumulating inventory data in Excel spreadsheets as a temporary solution. For making further move of data into a database easier, we recommend following five simple rules while computing data into Excel:

1) Adhere strictly to recording titles, subtitles and column headings on specific lines

2) Design the spreadsheet so that no field (cell) contains aggregate data. For example, Column 3 in Table 1 below (Број листа непокретности и поседовног листа), would need two fields: prefix (document type) and document name. This way, the prefixes can be examined separately for consistency. For Column 4 (Број кт. парцеле), parcel numbers, also two fields are needed, representing the numbers before and after the slash. This allows to avoid typing the slash that usually causes problems.

3) Preferably, use filters to check unique values in each column, and correct inconsistencies. This would help avoid data recorded in the wrong column, inconsistent entries, etc. It is recommended to check each column at the end of the day, to avoid accumulation of errors.

Microsoft instructions on how to list unique values in Excel can be found here:


An equivalent set of instructions for OpenOffice can be found here:

http://openoffice.blogs.com/. A polite protocol is to ask for permission to use these instructions (solveig@getopenoffice.org), which is customary granted.

4) Use either Cyrillic or Latin characters for data, but not both.

5) Standardize how data is computed and use only these standard codes, to avoid differences in punctuation or characters typical for written documents, or use other ways to unify records. For example, the prefix in records of Column 3 (Број листа непокретности и поседовног листа) in one of municipalities had 9 different forms of the same information:

п.л.
л.п.
л н.
л. н.
л.н.
п. л.
п.л.

16 This Annex uses examples and some specifics from Serbia, though the rules and substance remain reasonably universal..
The computer sees each of these values as separate. If data are recorded in this way it loses value. If the values that meant the same thing were always entered the same way it would be easy to come up with all the documents that had a "п.н." prefix. Otherwise, any list of documents that might be requested from the spreadsheet using a simple spreadsheet filter, for example, will be incomplete.
Table 1: Local Government Unit Inventory of Real Property Units

As of: __________________________

<table>
<thead>
<tr>
<th>Inventory Number</th>
<th>Cadastral municipality</th>
<th>Number of the real estate document and ownership document</th>
<th>Number of cadastral parcel</th>
<th>Address</th>
<th>Type of real estate according to cadastre records</th>
<th>Docu ment as a legal basis for ownership right</th>
<th>Current use of real estate property</th>
<th>Surface of the facility in m²</th>
<th>Surface of the land in m²</th>
<th>Condition of Buildings or Premises</th>
<th>Level of Use of Real Property Unit</th>
<th>Entity Where Asset is Recorde d in Balance Sheet</th>
<th>Entity Responsible for Real Property Management &amp; Maintenance</th>
<th>No. Of Tenants</th>
<th>Functional role</th>
<th>Restitution Status</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Col. 1</td>
<td>Col. 2</td>
<td>Col. 3</td>
<td>Col. 4</td>
<td>Col. 5</td>
<td>Col. 6</td>
<td>Col. 7</td>
<td>Col. 8</td>
<td>Col. 9</td>
<td>Col. 10</td>
<td>Col. 11</td>
<td>Col. 12</td>
<td>Col. 13</td>
<td>Col. 14</td>
<td>Col. 15</td>
<td>Col. 16</td>
<td>Col. 17</td>
<td>Col. 18</td>
</tr>
</tbody>
</table>
Directions for Completing Table 1

Table 1 should provide a list of all real property units currently owned or possessed by the local government.

**Column 1   Inventory Number**
Enter an inventory number assigned by the local government to the real property unit. The inventory number should be permanently assigned to the real property and not used for any other real property unit. If the real property is disposed of the number assigned should not be used again.

**Column 2   Cadastral municipality**
Enter the name of cadastral municipality.

**Column 3   Number of the real estate document and ownership document**
Enter the number of the document where the real estate is registered (real estate document– list nepokretnosti and ownership document – posednovni list). Note that the same number can appear for several properties (if they are registered by the same document).

**Column 4   Number of cadastral parcel**
Enter the Cadastre Number, if any, assigned to the real property unit in this column.

**Column 5   Address**
Enter the street address, if any, as specific as possible. (street name, number, floor, and any other mark). If there is no street address, enter a short description that locates the real property.

**Column 6   Type of real estate**
Enter type of property according to the cadastre records. Establishing certain number of categories as types of properties would be helpful. It would help avoid different names for similar or the same type of property and will be possible to make analysis of property portfolios. For example: housing facility (стамбени објекат), housing building (стамбена зграда), housing building for collective housing (стамбена зграда за колективно становање). Pick one category title and use it for all, to help the recognition you can also a side of making up category create short description.

**Column 7   Document as a legal basis for ownership right**
Enter the title of public or private document that confirms the ownership right. For example:
- Ownership document from cadastre,
- Real estate document from land book,
- Purchase contract

**Column 8   Current use of real estate property**
Enter the current use of the real property unit using one of the following types:

Single Use: When the whole real property is occupied or used fully or predominantly for one function (for example, City Hall, library, office, or apartments), enter this single use or function. Choose from the following:
- Administration  (clarification: Notes may specify: City Hall, etc.)
- School
- Kindergarten
- Sport
• Culture
• Residential – Detached single family
• Residential – Multi-family (apartments)
• Commercial (clarification: includes any commercial uses: office, service, retail, etc.)
• ME (clarification: municipal service enterprise)
• Industrial (clarification: this will include any manufacturing/warehouse/distribution)
• Parking
• Market
• Vacant construction land
• Agriculture
• Other

Multiple (Mixed) Use: When the real property is occupied by more than one type of user or used for more than one function, enter “Mixed” and specify the uses in the column Notes (# 18). An example of mixed use would be where City Hall is used one-half by local government and one-half rented for commercial purposes. In this example, the entry should be “Mixed”, and in Notes: City Hall and Commercial”.

Column 9  Surface of the facility in m2
Enter the total floor area (in square meters) of the main functional structure(s). For example, if a real property unit includes a school building, a separate sports building or facility and a small storage structure; enter only the sum of the school building and sports facility area.

Column 10  Surface of the land in m2
Enter the area of land for this parcel in square meters

Column 11  Condition of Buildings or Premises
Enter the condition of the buildings or facilities. Enter the condition as follows:
(1) Excellent: building or facility new or near new condition with only periodic scheduled maintenance required,
(2) Good: building or facility requiring some restorative or rehabilitative maintenance,
(3) Satisfactory: building requires more significant maintenance to continue occupation,
(4) Poor: building or facility requires major periodic rehabilitation or restoration to continue occupation
(5) Unable to be occupied: building or facility is in such bad physical condition that it is unsafe or impractical to occupy it.

Column 12  Level of Use of Real Property Unit
Enter the level of usage of the building, facility or land. For example, if land is leased for crops and only three-fourths of it is cultivated, enter 75%.

If the building was a former school building with half of the space used for sports and half for music but the sports have been relocated elsewhere, then indicate 50%. When in doubt as to what to indicate, develop a ratio of current use of facility to total area in square meters. Thus, in our school example, if the building of 6,000 square meters is only using 4,000 square meters, indicate the percentage as a ratio of 4:6 or 67%.

Column 13  Entity Where Asset is Recorded in Balance Sheet
Enter the name and the legal status (i.e., municipality itself, municipal budgetary organization, municipal enterprise, joint stock company, or other) of the legal entity where the real property object is recorded in the balance sheet or other accounting records. If the real property object is not placed on anybody’s books, enter the name of the entity controlling it.

**Column 14 Entity Responsible for Real Property Management & Maintenance**
Enter the name of the party primarily responsible for the real property management.

**Column 15 No. Of Tenants**
Enter the number of tenants. In some cases the number of tenants may not be clear. For example, the city hall building may be occupied by the local government, two subsidiary departments, and four commercial tenants. In this situation, if the two subsidiary departments have their own budgets, there would be seven tenants. If the subsidiary departments do not have independent budgets, there would only be five tenants since the departments would be considered part of the local government. Another example, a library rents out part of the library for copy and computer services but there is no separate lease. In this case the number of tenants is one.

**Column 16 Functional role**
Enter the functional use category in this column. The classification is based on the municipal asset management plan and is presented as three functional uses:
(A) real property that is used for mandatory functions intrinsic to the local government responsibilities;
(B) real property used for non-obligatory local government functions such as social, cultural, or sports function,
(C) real property that is owned and used for non-governmental functions (e.g., surplus real property).

**Column 17 Restitution Status**
Enter a code that indicates the restitution status of this real property unit. For example, this codification may include such groups as:
1. confirmed ownership of the local government;
2. confirmed ownership by public institution;
3. restitution claim filed and under consideration;
4. claims are possible but not yet filed;
5. restitution confirmed by court;
6. other.
Codification should cover most typical cases and should be developed by local government lawyers

**Column 18 Note**
Enter any comment clarifying the issues related to this property.
Table 2: Real Property Valuation Table

For the Year: ____________

<table>
<thead>
<tr>
<th>Inventory Number</th>
<th>Initial Book Value In 000 Dinars</th>
<th>Depreciated Book Value In 000 Dinars</th>
<th>Date of Real Property Unit Appraisal or Purchase</th>
<th>Appraised Market Value In 000 Dinars</th>
<th>Appraiser/Valuer Name</th>
<th>Financial Liens Imposed on Real Property In 000 Dinars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Column 1</td>
<td>Column 16</td>
<td>Column 17</td>
<td>Column 18</td>
<td>Column 19</td>
<td>Column 20</td>
<td>Column 21</td>
</tr>
</tbody>
</table>
Directions for Completing Table 2

Column 1
Enter the number for inventory used in Table 1.

Column 16
Enter the original cost of acquisition or construction incurred by the current owner. This amount should not be reduced by depreciation.

Column 17
The entity that accounts for the real property should provide the depreciated value, if any, to be entered in this column. The basis for depreciation should be included in a note to the table. For example, if the Ministry of Finance determines the depreciation rate for specific real property objects the depreciation factor should be stated in the note.

Column 18
Enter the date of the real property appraisal if any. If no real property appraisal has been done, enter none.

Column 19
Enter an appraised market value if there is one. If the appraised market value is not Known (i.e., appraisal was not done) enter none.

Column 20
Enter the name of the independent appraiser or internal asset manager estimating the fair market value of the asset.

Column 21
Enter the amount of financial liens if any associated with this real property unit. In the most typical case, this may be a loan secured by this real property unit.
APPENDIX 3: Approaches to parking management

REPORT ON PARKING

Prepared by:
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Introduction

The average car is parked for 96% of its life, and driven for one hour per day. This puts into perspective the magnitude and importance of parking within modern municipalities. A Parking Program which controls on-street parking and encourages off-street parking can increase safety, economic growth, and quality of life within a municipality.

A Parking Program can ensure that hydrants, fire lanes, and other restricted areas remain open and available to emergency services. Public services such as buses can serve passengers without blocking traffic or requiring passengers to enter the roadway. The safety of pedestrians can be increased by eliminating obstacles on sidewalks, at entrances, or in crosswalks. The elimination of double parking can increase general traffic safety, and reduce the congestion which often leads to accidents.

Parking is a driver of economic growth. It is an ancillary service, allowing people to do the other things they really want to do—live, work, shop, etc. A well-designed Parking Program will promote the best and highest use of spaces, giving everyone a chance to park where they need to, and providing businesses with the turnover needed for customer access and loading zone availability for deliveries.

A Parking Program can also help create a more livable city, more attractive to new businesses and new residents, through reducing congestion, clearing sidewalks, and improving air quality by reducing the overall volume of traffic, as people find parking spaces sooner.

Overview of a Municipal Parking Program

The first step in developing a Municipal Parking Program is to define the issues, meaning:

- understand the current environment;
- analyze the current and future requirements; and
- identify action items.

Once the issues have been defined and understood, a Parking Program can be developed by planning creatively, but realistically, meaning:

- develop alternate solutions;
- determine feasibility; and
- make optimal choices.
The final step is to implement the solutions developed through the planning process, by focusing on ways to

- choose a form of organization;
- create the proper legal environment; and
- promote the development of parking.

Define the Issues

The goal of defining the issues is to ensure the Parking Program addresses the actual problems of the municipality, rather than just assuming that the problems are known, or applying a generic solution. Parking is a micro-market, which means that typically the demand for a given parking location comes from a very small area, and parking locations that are within a few hundred meters of each other don’t serve the same customers. A failure to understand a municipality’s micro-markets is likely to result in an inefficient and ineffective Parking Program.

Understand the Current Environment

A Parking Supply and Demand Study is the first step in defining the issues, and is used to create an in-depth understanding of the current parking environment.

The steps in determining parking supply are:

Define the Area of Interest

Defining the area of interest is typically a straightforward process of defining the boundaries within which to measure the parking supply. The objective is to capture the area within which heavy daytime use of parking spaces occurs. Of primary interest are areas used by employees of businesses and offices, and visitors to commercial, government and business establishments. In some municipalities, it may also be necessary to capture areas with a high demand for residential parking.

Define Parking Zones for Key Generators

Once an area of interest is determined, sub-zones should be defined to reflect the parking supply available to serve key generators of parking demand. Generators are more fully explained below, in the Parking Demand section. The objective of defining parking zones is to recognize the micro-market nature of parking, and to recognize that walking distance is the key determinant of whether a particular parking facility is actually part of the parking supply for a given generator of demand. Depending on the nature of each generator, zones typically range in size from 125 to 350 meters of actual walking distance; and the more the parking costs or the shorter the stay of the parker, the shorter the acceptable walking distance will be.

Categorize Supply

Once parking zones are defined, the supply of parking spaces is determined by survey. The goal of the survey is to determine the number, location, type of facility (on-street space, off-street surface lot, off-street structure), type of access (public or private), type of parking (monthly, daily, hourly) and price of each legal parking space within the area of interest.

Adjust Supply to Effective Supply
Effective supply is a concept that recognizes that people will perceive a parking shortage, even if one does not exist, if the occupancy of parking spaces is very high. Therefore, in planning, there should be a “cushion” of excess spaces, so that people perceive that spaces are always available. Typically, effective supply is set between 85% and 95% of actual supply.

The steps in measuring Parking Demand are:

**Identify Generators**

As mentioned in the Introduction, parking is an ancillary service, needed by people to access their ultimate destination. These destinations are known as Generators of demand. The most common generators in a municipality are:

- Central Business District
- Government/Legal
- Office Buildings
- Retail Centers
- Mixed Use Complexes
- Hospitals
- Schools
- Residential Areas

Once Generators are identified, they are used to define sub-zones for the Parking Supply survey. They are also used in determining user demographics and trip purpose, as described further below.

**Observe Usage**

The critical part of measuring parking demand is conducting a survey on parking space usage, using a sample of parking spaces within each parking zone. This isn’t a random survey—survey areas should be chosen that best represent the parking situation in each zone.

A Usage Survey covers both legal and illegal parking spaces. Many aspects of parking space usage can be measured, with the most common being:

Occupancy—how long the space is occupied during a survey day.
Duration—the average length of time a vehicle occupies a space.
Turnover—the number of different vehicles occupying a space.
Peak Hours—the hours in which demand for parking is at its highest.
Peak Demand—the highest number of vehicles parking during the survey day.

**Determine User Demographics and Trip Purpose**

It is not enough to know how parking spaces are used, information should also be gathered by survey on who is using the spaces and why. The common demographic classifications are:

- Employees
- Management—upper, middle, lower
- Staff, Clerical
- Hourly
Visitors
Infrequent vs. regular
Short-term (2 hrs or less) vs. long-term
Residents
Other categories reflecting any special characteristics of the survey area, such as students

The most common trip purpose classifications are:

Work
Shopping
Personal Business
Sales and Service
School
Home
Social and Recreational
Other

Unlike parking supply, which is determined through a 100% survey, parking demand is determined through a more limited sampling process. However, a properly chosen sample, a tight set of procedures, and close oversight of data gatherers can ensure the collection of robust information which provides an accurate enough summary of current parking demand.

Analyze Current and Future Requirements

Once the supply and demand data is collected and collated, the next step is to compare supply and demand for the entire area of interest, and by sub-zone, to determine where there is a shortfall of supply, where there is an excess, and where parking is in equilibrium. In addition to determining the quantity of excess/short spaces, the user demographics or trip purposes that are creating the shortfall/excess in a particular zone should be determined. The end result of this process is a schedule of where parking is required, at what times, and for what purposes, throughout a typical municipal day.

Of course, this schedule reflects current needs. The next step is to predict probable or potential changes based on general assumptions about growth and specific knowledge about planned new projects, changes of use of existing projects, etc. This can be a difficult process, as the planning horizon encompassed within a Parking Program is typically 10 to 20 years, and often includes consideration of parking structures which can have a useful life of 50 years. But it is an essential step in implementing a Program that provides adequately for future needs without overbuilding in the short term.

Identify Action Items

Once the current and future parking requirements are determined, the next step is to determine what needs to be done to meet those requirements. There are four basic courses of action in this regard:

Organize or Improve the Existing Parking Supply

Implementing new or revised procedures, systems or operating methods for the existing supply can often increase the number of available, usable spaces.
Increase the Parking Supply

The parking supply can be increased by creating new spaces on-street, in surface lots, or in parking structures.

Manage demand

It may be possible to use regulations and incentives to influence where and when people park. In this case, the total number of parkers remains the same, but time and/or location shifting is used to balance out areas of shortfall and excess.

Decrease demand

Regulations and incentives can also be used to decrease the total number of parkers, by encouraging them to reduce the number of trips they make, or use alternate forms of transportation.

Plan Creatively, but Realistically

At this point in the process, the issues have been defined, and the next step is to make concrete plans to solve these issues.

Develop Alternate Solutions

An effective Parking Program starts with the development of many potential solutions to meet the identified action items. Nothing should be dismissed outright as too small in size or too narrowly targeted in scope. A number of small incremental changes can have a big impact at low cost. Alternate solutions can generally be grouped into three categories:

Increasing the operational efficiency of current parking.

These solutions organize or improve the existing parking supply. There are many options here, such implementing new or improved on-street parking regulations and systems, or re-striping the spaces in a surface lot to increase capacity, or increasing usage of a parking structure by improving access, lighting and security.

Implementing New Pricing, Time Limits or Incentives.

These solutions manage or decrease parking demand. Options include creating a variable pricing structure for parking to encourage long-term parkers to move to areas with a longer walking distance, implementing time limits to encourage turnover, or using incentives to encourage alternatives to driving.

Developing New Facilities

These solutions increase the parking supply. New facilities can be new on-street spaces, new surface lot spaces, or new parking structures.

Determine Feasibility

Once a range of possible solutions have been identified, it is necessary to assess each one to determine its feasibility. The objective of a feasibility assessment is to be realistic about what can be achieved in the specific circumstances and environment in question. Alternatives that rely on unrealistic assumptions about the ability to pass
laws required to implement the solution, or to change peoples’ long-standing habits are alternatives which can doom a Parking Program to failure if they are adopted.

Feasibility should be evaluated from four perspectives: legal feasibility, social and economic feasibility, technical feasibility, and financial feasibility

Legal feasibility analyzes whether an alternative is permissible under existing law, or whether modifications to the law would be required. It also analyzes whether the alternative complies with land use regulations, and is supported by necessary parking regulations.

Social and economic feasibility analyzes how well each alternative addresses the identified action item, and whether the public will use the alternative, or make the behavior changes the alternative assumes. Opportunity costs associated with the alternative are also identified.

Technical feasibility analyzes whether the basic parameters of size, location, concept and operating plan are technically achievable.

Financial feasibility analyzes the projected income and costs of the alternative. Income includes both parking income, and non-parking income opportunities, such as advertising revenue. Costs include land acquisition; construction, equipment and fixtures; soft costs; operating and maintenance costs; major repairs; and debt service. Financial feasibility also incorporates sensitivity analysis, assessing how the financial projections will change if assumptions about the price, turnover, or occupancy are wrong.

Depending on the size and scope of a proposed alternative, a full financial feasibility study can be a complex undertaking requiring sophisticated analysis. But there are some simple formulas for doing a “first-cut” analysis:

**First-Cut Revenue Projections**

**On-Street Parking Revenue**

\[
\text{Revenue} = \frac{\text{Number of Paid Spaces}}{\text{Operating Days per Year}} \times \frac{\text{Daily Hours of Operation}}{\text{Hourly Rate}} \times \frac{\text{Average Daily Occupancy}}{\text{Average Payment Percentage (percentage of all parkers who pay)}} \times \frac{\text{Number of Enforcement People}}{\text{Violations Written Per Shift}} \times \frac{\text{Shifts per Year}}{\text{Violation Amount}} \times \frac{\text{Percentage of Violations Paid}}{\text{Monthly Fee}} \times \frac{\text{Average Occupancy}}{\text{Average Occupancy}}
\]
times 12

plus

Number of Daily Spaces times Daily Fee
times Average Occupancy
times Days Open per Year

plus

Number of Hourly Spaces times Average Hourly Fee
times Turns per Space per Day
times Days Open per Year

First-Cut On-going Costs Projections

On- and Off-Street Parking

20% to 40% of Gross Revenues for Operating and Regular Maintenance Costs

plus

Allowance for Major Repairs, depending on the facility type

plus

Debt Service, depending on financing method

First-Cut Investment Costs

On-Street Parking

Varies widely by system chosen; typically range from € 100 per space to € 600

Off-Street Parking

Land Acquisition—varies by local conditions

Construction, Equipment and Fixtures—from € 1300 (basic paving and striping) to € 4000 (drainage, lighting, signage, landscaping) for surface lots; from €10 500 to € 40 000+ per space for structures, depending on such factors as type of facility (above or below ground, open or closed requiring fire systems and ventilation), structural system (pre-cast or cast-in-place or steel), and local factors such as soil conditions

Soft Costs for contingencies, fees, soils and materials testing, legal fees, financings costs—15 to 35% of construction costs

Make Optimal Choices

Once the list of alternate solutions has been narrowed down to the ones that are feasible, the next step is comparing the remaining alternatives, and choosing the best.
The criteria for evaluating the alternatives should be defined, and ranked in order of importance, prior to beginning the feasibility and evaluation process. This prevents the criteria from being adjusted late in the process to favor certain projects at the expense of others.

Evaluation criteria typically mirror the feasibility issues discussed above—how does the proposed solution match up against the legal, social and economic, technical and financial constraints present in the specific situation.

The priority of these criteria may vary from situation to situation, depending on local characteristics. For example, aesthetics may be very important in one municipality, and less important in another. There may be legal constraints in some situations which are of critical importance; for example, a national law that is unlikely to be changed might prevent certain delegations of municipal functions. Some municipalities may think user friendliness is most important, where others may be more concerned with operational efficiency. The financial capabilities of municipalities may vary. This is why it is important to not only identify the criteria, but rank them.

All feasible alternatives should be evaluated against the criteria, and it is also important to consider synergies between alternatives where each of two or more alternatives might not satisfy the criteria independently, but together they do. This can be particularly helpful in aggregating small projects to create a cheaper, simpler alternative to an ambitious construction project that still meets the previously identified parking needs.

Implement the Solutions

Choose a Form of Organization

A municipality has several roles to fill in implementing the solutions contained in the Parking Program. One of the most important is choosing the form of organization that will implement the solution. These fall into three broad categories:

Public Direct—implemented directly by the municipality
Public/private partnership—the municipality and a private company work together in some form to implement the solution
Privatization—a private company implements the solution alone

In reality, these are not three distinct forms of organization, but rather points along a spectrum. Even in public direct operation, a municipality will often rely upon private suppliers of technologies and services, in relationships that go beyond just buying a product. In privatizations, municipalities often retain some control and rights (such as limits on pricing), making it really just an advanced type of public/private partnership.

In many parts of the world, public direct operation of municipal parking, especially on-street parking, has been the historical norm. But this has been rapidly changing over the last decade, as municipalities see public/private partnerships as a way to access new financing sources, reduce risk, benefit from specialized expertise and new technologies, ensure a steady flow of income, and increase flexibility.

There are many specific ways for a municipality to work with a private provider of parking goods or services. Among the most common are:

Outsourcing
A private company is hired to fill specific functions, such as revenue collection or maintenance. This is typically on a fee basis, though it may be on a percentage of revenue or costs, depending on the nature of what it provided by the private company.

Management Contract

A private company manages a complete operation for the municipality. The municipality receives all the revenues, and reimburses the private company for all approved expenses, plus a fixed or percentage management fee. The municipality generally retains control over operations, setting policies for the management company to follow. This can be a useful structure where customer service is very important, but it is usually not the most efficient structure, as it requires management at both the private company level, and then at the municipal level, overseeing the private company.

Leasehold

A private company pays a fixed and/or percentage rent to take over an operation for a term of years. The private company often has significant operational freedom, although the municipality can still impose certain constraints (such as on pricing). The municipality may also retain certain responsibilities, such as structural maintenance on a parking garage. If the leasehold involves significant investment by the private company, the terms can be quite long. Build-Operate-Transfer (BOT) arrangements, and their many variations, are often a form of leasehold—a private company gets a long-term lease of ground, builds and operates a parking structure for many years, and then the municipality assumes ownership.

Concession

A private company pays a percentage of revenues to take over an operation for a term of years. This typically gives the private company a maximum of operational freedom, although, again, a municipality may impose certain constraints. This can be a very efficient structure, as often the municipality has nothing to do beyond ensuring the accuracy of the payments received from the private company.

Joint Venture

A municipality contributes land, or an existing operation, to a new company in exchange for shares. A private company receives the remaining company shares for providing cash equity, project financing, and project development and management services. Depending on the particulars of the project, this can give the municipality a greater participation in short-term cash flow than a BOT, and also a greater say in operational policies.

Create the Legal Environment

A municipality also has the critical role of creating the legal environment that allows the chosen solutions to be implemented.

Of primary importance is making sure the proper enabling legislation is in place, to ensure that the chosen methods of organization and operation are legally permitted. This is especially critical when private companies will be involved, as they will be reluctant to commit time and funds to projects that are not completely secure legally.
Issuing a tender package for a project which still has legal uncertainties surrounding it will decrease the number of responses, and the financial offers of the responders. And even if private companies are not involved, a municipality should not be making financial investments until the proper legal framework is in place.

Municipalities must also ensure their land use regulations, including the master plan and zoning, support the chosen solutions. It is usually a good idea to perform a complete review of these regulations after a supply and demand study has been performed, to see if changes need to be made in light of the issues identified through that study process. During this review, it is important to keep in mind the “micro-market” nature of parking and the sub-zones identified in the study. There is often a tendency to say “there is land for parking over there,” without confirming that there is demand for parking over there. Due to the micro-market nature of parking, and the way in which parking demand can change as other changes occur in the municipality (such as construction of new buildings), it is helpful if the land use regulations have built in flexibility to recognize and adapt to changing realities.

Another important part of the legal environment is the municipality’s procedures for procuring goods and services. Procurement usually takes the form of either a tender or a sole source procurement. Sole source procurements should be viewed with suspicion in the parking environment, as parking systems and technologies are going through a period of rapid innovation at this time. A sole source procurement can keep a municipality from being exposed to these new ideas, causing it to fall behind the technology curve. If a technology is really so unique and special, then it should be able to demonstrate this in an open tender process, by providing tangible benefits other technologies do not. Sole sourcing the provision of services can be equally problematic in a dynamic environment, where the capabilities and performance of companies can change rapidly due to ownership or management changes, a failure to adapt to new methods, or complacency about service levels or fees.

There are a number of considerations to be taken into account in developing requirements for a tender, evaluating tender responses, and preparing a contract with the successful offeror, including:

**Specifications**

It is important to remember that the purpose of a tender is to implement a solution to a problem, not to purchase a particular technology or utilize a particular service. Similar to the problems with sole sourcing mentioned above, overly narrow specifications can limit a municipality’s options, and prevent it from utilizing the latest technologies and service innovations. When the tender is related to an existing operating system or project, then there is more need for specific requirements, to ensure the new works with the old. But the more open a project is, the more open the specifications should be.

**Required Experience**

There is a tendency by municipalities to require respondents to a tender to have very specific experience with the exact type of operation that is the subject of the tender. This is a safe approach, but it can be too limiting, as it can create a situation where only a small number of companies can even submit a response, potentially restricting the municipality’s access to new approaches and better financial terms. When writing experience requirements, the better approach is to focus on demonstrating particular functional capability, for example, in revenue collection and control, or maintenance, or customer service.
Financial Terms
It is important to be realistic about the financial prospects of a project, the associated risks, and the availability and cost of financing for the project. Municipalities often believe that these are issues for the respondents to sort out and account for in their offers. But if the related tender requirements don’t reflect economic realities, the results can include having no qualified respondents, or selecting a respondent who then fails to deliver the project.

Accountability Requirements
If the municipality will receive a percentage of income (gross or net), or will be responsible for reimbursement for costs, it is important that there be provisions to ensure financial data is accurately and completely collected and maintained. With regard to revenue control systems, many today offer the possibility of a workstation, or even a separate server, to be installed at the municipality for access to and/or storage of revenue transactions. At the very least, respondents should be required to demonstrate the integrity of their data collection and storage, including such items as security levels and audit trails. With regard to services, it is important to require a demonstrated performance record with regard to the collection and reporting of revenues to clients. In all cases, audit rights of the municipality should be detailed in the tender and the subsequent contract.

Contingency Plans
As mentioned previously, parking is going through a dynamic time, with many new technologies being introduced. It is inevitable that some of these technologies will not work adequately once they are installed over a large operating base, or will fail to find a large enough market to survive; or that a technology may survive, but a particular company supplying it may not. This creates a risk that a municipality may end up with a system for which there is no ongoing technical support or maintenance service. This is not a reason to avoid new technologies and look only at old, proven technologies; the performance and service features offered by the new systems offer too many advantages. But contingency thinking does need to be part of every tender process. One way of limiting the risks of deploying new technology is by having a private company make the investment. If the technology fails, the private company’s contract can be terminated, and a new tender issued. While this process will cost the municipality some time and lost revenue potential, the risk of a complete loss of investment by the municipality is avoided.

Constraints
Municipalities should be careful of imposing excessive constraints on how the selected company will operate in a service tender. One of the reasons for a tender is to access the expertise of the chosen company. Strict constraints on what that company can do, what services it can offer, what it can charge, etc., reduce the benefits of this expertise. In addition, the more constraints there are, the more respondents will reduce their financial offers, because constraints create risks. While in some circumstances there may be legitimate areas for municipalities to impose constraints (such as limiting price increases for certain services to inflation, or requiring certain operating hours), municipalities should think carefully about the rationale for each constraint included in a tender.
Promote the Development of Parking

Promoting the development of parking is a critical function of a municipality in implementing a Parking Program. One way a municipality does this is through minimum parking requirements, which specify the minimum number of parking spaces that must be provided for various types of new construction. Given the cost of building a parking space relative to its revenue potential, many developers would not build sufficient parking if given the opportunity. This creates an externality, where the costs of the developer's actions are borne by other nearby businesses and residents (due to vehicles filling the on-street spaces and parking illegally), and by the municipality, which then has to take remedial measures to provide adequate parking. By enforcing minimum parking requirements, municipalities force developers to provide an adequate supply of parking. This increases the overall supply of parking in the municipality and reduces the demand pressure for on-street spaces and other parking facilities.

Municipalities can also promote the development of parking through incentives, such as tax credits for building parking, or subsidies for parking operations. Tax credits which apply equally to all new construction can be a helpful way to stimulate private development of parking, which is a critical service, but one which is typically of borderline economic value, especially where the building of parking structures is involved. Subsidies need to be carefully considered. A subsidy to increase the parking supply can be good if appropriately designed, whereas subsidies to keep rates low are almost uniformly bad, as they distort economic choices and discourage competing private investment.

The most important way in which municipalities can promote the development of parking is the regulation of on-street parking. Parking needs to be considered as two interdependent pieces—on-street and off-street. If on-street parking is not regulated, people won't pay to park, and off-street parking facilities won't be financially feasible. If off-street parking does not exist as an alternative, on-street parking is difficult to control. At a minimum on-street parking regulations must encompass minimizing illegal parking. This usually reduces the supply of on-street parking enough to make some off-street parking feasible. In addition, on-street regulations can include payment for the use of on-street spaces. The most common model is that on-street spaces have the highest rates, to encourage turnover of spaces, and are zoned by rate and time limits. This generates a demand for lower-priced off-street spaces, particularly for employees and other all day parkers. The optimum end result is a coordinated system which offers a range of parking options and prices to meet a variety of needs, and encourages the development of parking facilities by private entities, lessening the burden on the municipality to "solve the parking problem."
APPENDIX 4: Annual Report on Property Asset Management

Guide on the Report Content and Structure

Introduction to the Guide

There are no hard and fast rules on how an annual report on property asset management should be structured and which information it should contain. It is important to recognize that the report should meet the needs of those for whom it is prepared. If additional categories of properties will be further identified, or if additional information is helpful in the management of the asset and its oversight by higher authorities, then the report format and content should be amended. Likewise, information included in the report may prove to be of little interest to those using the report, and it may be appropriate to omit it from future reports.

Initially, there will be a tendency to include more information. Those requesting that information should seriously consider whether that information will contribute toward improving the management of the assets or whether it is a matter of curiosity that will consume resources in presenting it without any significant benefit.

Conceptually, the report may be described as having three levels of detail:

Introductory Narrative Review
Summary Portfolio-Level Review
Detailed Property-Level Review

CONTENT OF REPORT

A. Introductory Narrative Review

This part may include:

Significant changes and improvements in property asset management: list all substantial regulatory and administrative changes that have happened during the year (such as the adoption of the new Ordinance on Property Asset Management of the Local government or changes in leasing practices or progress in inventorying municipal property and computerization of the inventory records or changes in how markets (green or goods) are managed, etc.)

Portfolio dynamics during the year: provide general narrative comments on restitutions, acquisitions, dispositions (privatization, sales, involuntary alienation), and new construction projects (started and finished) during the year, new PPPs launched.

Market and economic conditions related to local government property

Overall effectiveness of use of local government real estate. This is a complex topic, and it may take several years of experience to develop a useful analysis of each portfolio and to reflect this analysis in the Annual Report (some thoughts on the analysis of property performance are presented in Activity 9 and APPENDIX 5). Again, the goal is a brief narrative commentary, with more detail later in the report.
Issues that require attention of the local government or local council.

**B. Summary Portfolio-Level Review**

The purpose of this section is to provide an analysis of each portfolio of similar properties.

Properties should be sorted first by ownership (clear, unclear), and then further sorted according to its role in fulfilling the local government responsibilities, as discussed in Activity 4, i.e., mandatory, discretionary (social), and income generating property. They may then be subdivided further according to functional use. A separate piece on local government’s business interests (enterprises) and their property portfolios should be included.

**Note on Identifying and Sorting Properties:**

Sort by address, not by tenant or occupant space. Each property may have multiple tenants in separate premises within the property.

The Summary Portfolio-Level Review draws on and summarizes information in the Detailed Property-Level Review described below. It includes:

- Key characteristics of each property portfolio, including the number of properties, the Net Income and Cash Flow of each portfolio, and the value of the portfolio. Each “portfolio” should be an aggregation of similar properties such as government-occupied property (i.e., City Hall), types of surplus property, social housing, etc., as noted above.
- Total Net Income and Cash Flow earned by all municipal property for the entire year. An analysis of the investment performance of the Surplus (Income-Generating) properties. This analysis should address the aggregate Cash Flow and value of each portfolio of similar properties of this class to assist in determining the benefit of retaining them and to assist in identifying those requiring remedial action.
- An analysis of the total property-related subsidies offered to NGOs and other tenants of social properties in the form of reduced rent or free occupancy or additional cash or in-kind subsidies aimed for covering property expenses of recipients.
- An analysis of the cost of maintaining the social housing portfolio, including the negative Cash Flow and an estimate of the value (appraisal) of this portfolio if it could be sold into the private market as unsubsidized private housing.
- Capital transactions such as the purchase, sale, or major improvement of properties. These one-time transactions having implications for the longer term should be reported separately from operating results for any given year. List in a spreadsheet all disposition, acquisition, and financing transactions that occurred with information as follows for each transaction:
  - Asset Number
  - Address
  - Property type (office, retail, mixed use, apartment, vacant land site, etc.)
  - Transaction type (sale, restitution, alienation by a court order, purchase, etc.)
  - Net Proceeds if disposed (total less transaction expenses and debt repaid)
  - Total Cost if acquired
  - Debt incurred
  - Comments including reasons for the transaction
Show total Net Proceeds and Total Expenditures from these transactions.

C. Detailed Property-Level Review

For analysis and reporting purposes, properties may be sorted and presented by portfolio. For each property, present key information in a spreadsheet with columns as follows:

- Asset Number
- Address
- Category (mandatory, discretionary, surplus)
- Occupancy Percentage (for rental properties)
- Other Indicator of Effectiveness (optional, and may be portfolio-specific)
- Total Income
- Total Expenses
- Net Income (Loss)
- Market Value
- Return [Net Income Divided by Value as percent (xx.x%)]
- Capital Expenditures
- Recommendation:
  - Retain
  - Sell
  - Hold for Restitution
  - Hold for Nationalization.

For each property (both clear title and subject to nationalization or restitution), show Net Income, Market Value, and Return. Calculate Net Income and Return as a percentage of value. This analysis will assist in determining actions needed to improve the performance of each property and therefore the portfolio. Such actions may include specific physical improvement, revised rental rates, or sale.

Provide estimates of the effectiveness of the use of premises by NGOs (for example, how many hours per week their offices are open). Estimate the property-related subsidies provided to each NGO and other tenants of social properties in the form of reduced rent or free occupancy or additional cash or in-kind subsidies aimed for covering property expenses of recipients.

Provide estimates of forgone income for each applicable property. In particular, for the Investment Property Portfolios (business and residential rentals), estimate forgone income due to below-market rents and vacancies. A similar analysis should be prepared for each property used for social housing. (It might be useful to enclose a spreadsheet used for these estimates as an annex to the report).

Discuss costs and benefits associated with sport facilities, if such data are available (see APPENDIX 6). The operator of each sports facility should provide a complete accounting of the expenses it incurs and the income it receives from all activities on the facility or related to it. This information should be attached to the data reporting the direct income and expenses incurred by the city for such property. Because the city subsidizes the operators of such assets, the city is entitled to complete financial information regarding the assets from those operators.

D. Attach the following for each asset:
- Static Non-transactional Information Report (the content is suggested in Annex 3)
- Annual Operating Statement (the content is suggested in Annex 4)

ANNEXES TO THE ANNUAL REPORT

Annex 1
Asset Management - Real Estate Transactions
(Excel chart)

Annex 2
Asset Management - Real Estate Holdings
(Excel chart)

Annex 3
Static Non-transactional Information Report

The list below identifies data that should be included in this specific report; in reality, the data should be presented in a spreadsheet or database format.

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<th>Date of Review</th>
<th>Asset Number</th>
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<tbody>
<tr>
<td>Property Address</td>
<td>Property Manager (person)</td>
</tr>
<tr>
<td>Street Name and Number</td>
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</tr>
<tr>
<td>City</td>
<td></td>
</tr>
<tr>
<td>Zone</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Property Type</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apartment</td>
<td>Kindergarten</td>
</tr>
<tr>
<td>House</td>
<td>Factory</td>
</tr>
<tr>
<td>Office</td>
<td>Sport Facility</td>
</tr>
<tr>
<td>Warehouse</td>
<td>Multiple Use</td>
</tr>
<tr>
<td>Parking Lot</td>
<td>Other</td>
</tr>
<tr>
<td>Vacant Land</td>
<td>Agricultural</td>
</tr>
<tr>
<td>Retail store/service (barber, shoe repair, optician, doctor, etc)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Entity on whose balance sheet the property is kept</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restitution Status</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Reason for Retention (i.e., local government occupancy, income, legal requirement, or other)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Category of Function (classification)</th>
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</thead>
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<table>
<thead>
<tr>
<th>Property Manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Name</td>
</tr>
<tr>
<td>Manager (person) Name</td>
</tr>
<tr>
<td>Address</td>
</tr>
<tr>
<td>Telephone</td>
</tr>
<tr>
<td>Fax</td>
</tr>
<tr>
<td>Email address</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Building Size (Square Meters)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Land Area (Square Meters)</th>
</tr>
</thead>
</table>
Physical Description  (Text; i.e., Three story building containing office premises on upper floors and four retail shops on the ground floor.)

Tenant Roster

<table>
<thead>
<tr>
<th>Premise Number</th>
<th>Tenant Name</th>
<th>Area M²</th>
<th>Monthly Rent</th>
<th>Lease Expiration</th>
<th>Compliance Yes/No</th>
<th>Level of Use By Tenant (%)</th>
<th>Estimated Level of Use By Tenant (%)</th>
</tr>
</thead>
</table>

Inspection Data

- Date Inspected by Asset Manager
- General Condition (text with photos and completed checklist)
- Necessary Repairs and Cost Estimate

Capital Improvements Required

- Description of Needed Improvements
- Justification (Review of benefits or additional returns to be produced and/or consequences of not making improvements)
- Estimated Cost
- Proposed Commencement Date for Work

Appraisal or Informal Estimate of Value (Maintain historical record)

- Appraised Value
- Date of Appraisal
- Name of Appraiser
- Purpose of Appraisal (For example, to update record of fair market value, for guidance in sale, etc)

Encumbrances (Debt)

- Initial Debt
- Current Amount of Debt
- Interest Rate (%)
- Monthly Payment Amount
- Final Due Date

- Comments (Narrative describing any additional important information such as variable rate)

Insurance Information

- Type of Coverage
- Amount of Coverage
- Expiration
- Agent

- Name
- Address
- Telephone Number
- Insurance Company

Communal Fee (annual or monthly)

Completed by: __________________________ Date: __________________________

Asset Manager
Annex 4: Annual Operating Statement

This is a sample only. Some items may not be applicable, and others can be added as appropriate. The “Plan” or budget may be prepared on a monthly basis and year-to-date actual can be compared to year-to-date plan (i.e., January through the current month). Numerous systems are available to provide reports of this type with entries generated by the underlying transactions. For example, the payment of an expense or the deposit of rent generates a journal entry and the cumulative entries of that type appear in the statement as outlined below.

Capital expenditures for reconstruction or capital repair are not a part of Operating Statement per se, but they should be recorded and monitored in parallel with operating expenses, so they may be conveniently recorded immediately following Net Income.
### Property Address and Other Identification Data

**Income** | **Current Month Year To Date** | **Annual Plan**
---|---|---
Rent
Reserves (collected from tenant from which manager pays certain expenses as provided in Lease)
Parking
Late Charges
Concession Fees (i.e., vending machines)
Other/Miscellaneous
---
**Total Income (Sum of above)**

**Expenses (include only those that are paid by the municipality)**
Building Repairs (on-going small repair)
Parking Lot Repairs
Supplies (light bulbs, trash bags, etc.)
Landscaping
Gas/Heating
Electricity
Water
Janitorial/Cleaning
Garbage Removal/Hauling
Insurance
Taxes/Communal Fees
Management Fees
Legal Fees (rent collection, eviction, etc.)
Interest on property debt
Miscellaneous
---
**Total Expenses (Sum of above)**

**Net Income** (Total Income minus Total Expenses)

**Capital Expenditures**
Appendix 5: Indicators of Performance

A variety of indicators can be used to measure the effectiveness of the management of a portfolio of properties and of the individual properties within the portfolio. In time, asset managers will develop additional measures to continue to improve asset management practices as a result of their observations of the performance and composition of the portfolio. These measures, calculated by the asset manager or under his or her direction, will provide insights to the performance of the assets and suggest many opportunities to improve them.

These measures are useful only if they are properly understood. The asset manager must use judgment in interpreting the results of the calculations. The time at which the measure is taken may not be typical, and the asset manager must understand that the property has potential different from that appears at the moment.

Asset management is a role that requires experience, judgment, and the ability to analyze and interpret the implications of data. Otherwise, inappropriate decisions will be made.

Indicators for Investment Property

*Occupancy*

Occupancy is a measure of the use of premises (usually, rental). It does not measure the use a tenant makes of the space, but only that a tenant has the right to use the space under a lease. It is expressed as a percentage. A variation is Vacancy, where

\[ \text{Vacancy} = 100\% - \text{Occupancy}. \]

Managers of rental properties measure occupancy in two ways.

**Method 1**

The most common way is simply a calculation of the percentage of the area (square meters) of the portfolio under lease. An appropriate measure for residential apartments is the percentage of total apartments leased.

For example, a property containing 300 square meters with tenants leasing 270 square meters has occupancy of ninety percent (90%). It could also be said to be ten percent (10%) vacant. If an apartment building has ten apartments and nine are leased, it is ninety percent occupied.

**Method 2**

A less common way to measure occupancy is by rental amount. This reflects the fact that a vacancy in a property capable of generating high rent represents a greater loss than a vacancy in a less valuable property. It requires estimating the rental potential of vacant property as well as considering the actual rent being collected on leased property.
For example, if actual rent on a property is being collected at the rate of 9,000 Dinar per month and the estimated rent on vacant space in the property is estimated to be 1,000 Dinar per month, the property is estimated to have a rental potential of 10,000 Dinar per month, and is ninety percent (90%) occupied. Of a total rent potential of 10,000 Dinar, 9,000 Dinar are being collected.

Occupancy (or vacancy) is calculated for each property and for a portfolio of properties. Each property (separate asset) within a portfolio of properties is subjected to this calculation, and then the leased and total square meters (or collected and potential rents) of all properties (assets) are added together for a portfolio occupancy calculation.

Additional measures are useful. For a widely diversified portfolio of properties, the occupancy for each property would be calculated. Then the properties would be aggregated into property-type portfolios. All office properties would be considered in calculating the office occupancy and all apartments would be considered in calculating the apartment occupancy. In the same manner, the occupancy would be calculated for the portfolio of retail (store) properties and for manufacturing and industrial properties, etc.

Finally, a total occupancy of all properties would be calculated. It is acceptable to report separate occupancy percentages for residential properties and for business properties because of the common practice of measuring apartment occupancy by the number of units rather than floor area and the related difficulty of consolidating business property (square meters) and apartments (number of units).

Occupancy is calculated as of a given date. It will change over time as tenants sign leases and then leave when the lease expires or when the business fails. If rental income is used as the basis for calculating occupancy, a periodic rental amount (usually monthly) is used.

**Return on Investment**

This calculation simply divides the annual net operating income by the estimated property value (market value). Value is based on the highest price a buyer would pay for the property, not the cost to replace it. It is intended to measure the profitability of a property, which can be compared to other investments such as bonds.

“Net income" is often called "cash flow." Expenses such as depreciation are not considered in calculating the return on investment because they are not actual cash expenses.

It is important to recognize that the net income in a given period may not be representative of the potential performance of the property. For example, a property in poor condition and undergoing renovation to make it suitable for occupancy may have no rental income and in fact may have expenses such as water fees and electric fees. The resulting loss could suggest that the property is worthless. A “return on investment" for such a property is not relevant, unless one considers the potential net income after the renovation is complete.
Likewise, the income on a fully rented property may be deceptively high. Most properties over time experience vacancy and/or collection problems, and it is unrealistic to make investment decisions based on returns that may not be typical of the longer term.

If the property is subject to debt such as mortgage financing, then it is important to be careful in calculating the return on investment. It can be calculated in two ways. First, the income before deducting interest on the debt divided by the value of the asset is very useful in evaluating the performance of the property. (The performance of the asset is not changed by financing. The rents and operating costs will be the same with or without debt.) Second, the return after deducting the interest cost divided by the value of the equity (the value of the asset minus the amount of the debt, not the value of the property alone) shows the performance of the investment.

For example, a one million Dinar property with a 400,000 dinar debt has equity or an investment of 600,000 Dinar. If it produces 100,000 Dinar income before interest expense, the property return is ten percent (100,000/1,000,000). If the interest expense is twelve percent of the 400,000 debt, or 48,000 Dinar, then the income after interest is 100,000-48,000, or 52,000 Dinar. The return on equity is 52,000/600,000, or 8.67 percent.

As with occupancy calculations, return on investment can be calculated for each property, for portfolios (or “sub-portfolios”) of property types, and finally for the entire property portfolio.

This analysis is useful because it offers the opportunity to compare an individual property with the entire portfolio. If a property is producing a return below the average of comparable properties in the portfolio, it should be examined to determine if there are operational aspects of the property that could be changed to improve its performance. If no improvements can be made, perhaps the property should be sold and the proceeds invested in other assets.

Likewise, a property performing above the average may be retained as an important component of the portfolio. However, it may be performing in an unsustainable manner and, in its excellent position, may be a candidate for sale.

Indicators for All Types of Property

The above indicators are not relevant for administrative properties and other properties that do not produce income. It is assumed that these properties perform a necessary governmental or social function instead of cash revenues. Here, the asset manager must assure that the properties are truly needed for local government purposes and that they are fully in use. If not, there may be opportunities to lease portions of them to generate additional income and reduce the burden on the city budget.

Likewise, social housing is intended to meet a social need and not to produce a large cash return. For social housing and administrative properties, other measures are useful as shown below.

Operating Analysis
Measures can be developed to more fully understand the operations of a building. These are usually based on costs (or revenues) per square meter. Examples are:

- Heating costs per square meter
- Water costs per square meter
- Repair costs per square meter
- Electricity costs per square meter
- Rent per square meter

These measures are useful in comparing properties provided the properties themselves are comparable.

Although administrative and other properties may have no income and therefore no measurable return on investment, their operating costs are subject to analysis and improvement. This is particularly true if the property is comparable to income-producing assets in the portfolio. Administrative offices may be comparable to leased surplus offices, for example, and operating costs can be compared.

Likewise, social housing may not produce market rates of rent, but expenses should not exceed those of similar properties that are not subsidized.

**Deferred Maintenance**

Sometimes, under-investment in property maintenance takes place, and when it happens systematically, this results in property deterioration and de-valuation. Monitoring deferred maintenance is important, and some rough estimates at least may be obtained by comparing annual planned and actual expenses on building repair (see Annual Operating Statement).

**Portfolio Composition**

Portfolio managers find it useful to determine the relative proportion of the portfolio each property type represents. (Property types could include administrative properties, surplus offices, retail/stores, factories, market apartments, social apartments, sports facilities, and kindergartens. To make this calculation, the value of each property type is divided by the total value of all properties. The resulting percentages may be presented in a pie chart or numerically.

This analysis helps asset managers and owners understand the composition of the portfolio and may reveal risks otherwise unknown to the asset manager. If, for example, the portfolio is concentrated heavily in stores, a new shopping center may attract tenants away from local government-owned properties, exposing the local government to vacancy and a reduction of cash flow.

**Data Sharing**

Asset managers in some countries have found it very beneficial to share certain data. For example, real estate portfolio managers have formed an association called the National Council of Real Estate Investment Fiduciaries (NCREIF). Member firms
confidentially submit investment performance data on their properties to the association, which then consolidates that data and presents it in a way that allows members and the public to see investment performance (profit) information for large classes of property according to type, size, and location. (No data is provided if the class includes fewer than ten properties. This limitation is intended to protect the confidentiality of the data regarding each property.) Data on about 1,500 properties is involved and includes both income and expense data as well as appraisal data so that analysts can see both profits and gains in values of a broad sample of properties.

Other organizations including the Institute of Real Estate Management and International Council of Shopping Centers collect, analyze, and publish data regarding rents and expenses of various types of property. Asset managers and other real estate practitioners use this data as a standard against which to measure the performance of their own properties and to find ways to improve property performance by focusing attention on specific aspects of property operations.

Cities or municipalities with similar property portfolios and asset management challenges may find it useful to join together to share property data so that each can learn from the others and so that standards can be developed against which to measure the performance of each property. It would be particularly useful if private owners of property would also share data in this way so that local governments could compare the performance of their assets with that of properties in the private sector.

**Conclusion**

These are measures that asset managers find useful. As the asset management process evolves, managers themselves will find additional ways to measure the performance of their portfolios according to the unique composition of those portfolios.
APPENDIX 6: Some Specifics of Managing Sport Facilities

The measurement of the effectiveness of a portfolio of sport facilities is significantly different from that of a portfolio of investment properties. The purpose is to provide recreational resources to a community rather than to produce investment returns. Nevertheless, measures are possible.

A facility has value. Replacement cost is irrelevant. The asset has a value in the market. In an auction (tender) potential buyers would offer some amount based on their potential use of the property. It could be a continued use as a sport facility with users paying for the privilege of access, perhaps through monthly or annual membership fees. Value would be estimated by capitalizing the expected income from users or members. The improvements could be demolished and the land used for another purpose such as housing construction. In this case, value would be based on the value of the land less the cost of demolition.

The local government incurs an opportunity cost by owning the asset. This means that the local government is foregoing the income that could be generated from an alternative use of the asset or alternative investment of an amount equivalent to the market value of the asset. For example, if a facility is worth one million Dinar and the best alternative investment is a bond or bank account that would yield five percent, then the opportunity cost is 50,000 RSD.

Additionally, the local government may be providing direct cash subsidies to the club that controls the facility. It may also be incurring direct expenses associated with the facility, another form subsidy. These direct costs are in addition to the opportunity cost or foregone income on the value of the investment. (The cost of the property is irrelevant. The only meaningful value is what buyers in the market would pay for the property. The cost is only of historical interest and has no investment significance.)

(The total recurrent cost to the local government of providing the facility) = (The opportunity cost) + (Any direct cash subsidies) + (Direct expenses on the facility and management costs)

The local government should expect benefits for incurring these expenses. Because investment income is not the goal, there must be other benefits associated with the asset. In fact, those benefits are received in the form of recreational opportunities for the community. While everyone will not participate in recreation, some will. The local government must determine how many citizens make use of the facility. Then, a cost per user can be determined.

The goal should be to reduce the cost per user or participant. This can be achieved by increasing the number of users and/or decreasing the cost of owning and operating the facility.

If every citizen does not have a reasonable opportunity to use the facility, then its value to the community must be questioned. The local government should resist making it available only to the elite few athletes who can qualify competitively for a team but rather should be sure that all citizens have the opportunity regardless of athletic ability. Of
course, competitive teams should have the opportunity to use the facility, but their use should not be exclusive of other citizens. If the objective is to limit use only to those with exceptional ability (either exclusively or for most reasonable hours of operation), then the local government should consider requiring the users to pay all costs including a rent comparable to the return from other investment opportunities.

If in fact a facility is available to all citizens, then every effort should be made to control expenses consistent with good management practices, to generate revenues from food concessions, etc., and to promote use as widely as possible.

As costs per user are studied, it may become apparent that certain facilities cost more than others to support. This may lead to the decision to close, sell, improve, or otherwise act to improve the benefits to the local government of owning the asset.