Best Practices Methodology for Real Estate Assets Department

January 31, 2007

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Mr. Jim Barwick
Director
Real Estate Assets Department
City of San Diego
1200 Third Street, 17th Floor
San Diego, California 92118

Re: Best Practices Methodology for Real Estate Assets Department

January 31, 2007

Dear Jim:

We are pleased to present this best practices methodology for the Real Estate Assets Department. This document includes a description of our efforts and data sources, and documents our findings. We hope you find it informative.

If you have any questions, please feel free to contact me at 312.224.3185 or by e-mail at Noah.Shlaes@grubb-ellis.com.

Sincerely,

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Executive Summary

The Real Estate Assets Department of the City of San Diego is in need of a new business model. Until recently, it has functioned in a stewardship role, continuing to apply methods and policies to situations as they arose, without a central plan. The City's large portfolio of income-producing real estate was managed without a formal portfolio plan. Departmental space was provided as needed, without considering use by other departments, availability, or possible changes in the portfolio. Public service properties were acquired on an as-requested basis, without reference to an overall plan. In general, the organization lacked the authority to manage its portfolio, and instead made small individual transactions to provide services as best it could. This is not the way to achieve optimal performance from the City's assets, nor the way to provide optimal customer service. A successful business model must focus on three areas – real estate investment portfolio performance, operating portfolio planning, and customer service.

The City of San Diego portfolio includes a much greater proportion of real estate leased to third parties than is found in other municipalities or government organizations. The business model for this portion of the portfolio should be based on practices in investment real estate organizations rather than those found in municipalities. The processes found herein are drawn from the portfolio strategies of real estate investment management organizations and real estate investment trusts.

Processes – In this report, we recommend a set of business processes that focuses on the areas of real estate investment portfolio performance, operating portfolio planning, and customer service. The most significant of these include the development of an overall portfolio plan, comprehensive evaluation of the City's property, an occupancy strategy, and a separate portfolio plan for the City's income-producing property. Together, these provide a framework for all real estate decision-making at the City. These rigorous processes also include gathering information to drive continuous improvement. If they are consistently enforced, performance of the City's real estate portfolio will improve rapidly.

People – migrating to this business model will require several changes that affect people in READ. The first of these is a renewed commitment to training, including training on new business processes, training on new technology, and an expansion of training from professional organizations that offer a broader range of real estate techniques to the group. Such training is crucial to the department, and must be mandatory for personnel. Second is the creation of a component of the team devoted to portfolio management, as opposed to asset management. This small team would be responsible for developing the consolidated portfolio plan, and for monitoring property performance and ongoing real estate activity.

Performance measures – the necessary monitoring of READ's activities breaks down into three components. First is the creation and addition of standard real estate performance measures, including calculation of rates of return, occupancy, space quality, and comparison to market. The data to create many

of these already exists in READ, but not in a format that permits portfolio analysis. The implementation of new real estate technology will create an opportunity to provide these kinds of performance measures. Second is the set of measures relating to execution, including response times, unresolved transactions, histories of negotiation, and accuracy and completeness of property records. The last set includes performance measures related to managing the transition to a new business model. This includes adherence to schedules, implementation planning, and successful transitions.

Technology – the existing electronic database of real estate information in READ is inadequate to support these processes. It must be replaced with a modern system that supports portfolio monitoring, performance measures, project tracking, and the information necessary for property agents to accomplish their work. We have not found an off-the-shelf application to address this issue, nor have we found a municipality that is succeeded with a single product. A best-in-class solution, composed of specific tools for lease administration, portfolio management, and project management, is likely the best answer for the diverse portfolio and functions of READ.

Authority – for READ to achieve superior performance of its real estate, it requires improved use of authority. Specifically, it should operate under the following principles:

- **Batched approval** – most real estate decisions requiring Council action should be approved as part of a portfolio plan, rather than as individual transactions. The creation of an annual planning process permits both READ and Council to devote appropriate attention to these decisions.
- **Authority within a box** – once a portfolio plan is approved, including thresholds and terms for typical transactions, READ should be free to execute those transactions that comply with these guidelines. The appropriate focus of Council is to periodically review the guidelines and to address exceptions.
- **Management by exception** – in a modern portfolio management environment, the focus should be on anomalous transactions, and on the monitoring of a flow of routine transactions.

* * *

The City of San Diego is undertaking to accomplish something that has not been achieved in most cities. To adopt this business model will require significant effort, but this effort is necessary to make appropriate use of the City's resources.

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Introduction

The Real Estate Assets Department at the City of San Diego is in need of a new operational model. Grubb & Ellis was engaged to review the department, its peers, and other related organizations and to recommend a best practices-based methodology for the department. This report presents our process, conclusions, and research.

Our assignment

Under the terms of our engagement letter, the tasks to be addressed in this report are as follows:

- Provide a "Best Practices" methodology based on both private sector and governmental real estate industry standards for the management of its real property.
- Provide performance measures for department and its real property inventory.
- Provide assessment of organization's real property management practices in its capacity as lessor and provide recommendations to improve efficiency and accountability.
- Provide a review and analysis of the existing authority (statutes, regulations, policies and other authority) that governs the management of its real property, and recommend changes to the existing authority to improve required processes and to maximize efficiency.
- Provide a real property abstract suitable for tracking each site in the City's real estate inventory in accordance with standard asset management practices
- Provide a brief summary, approximately two (2) pages including a review and analysis of leading Enterprise Resource Planning (ERP) solutions in the market as a viable solution for the management of organization's real property operations and inventory and recommendation of each leading ERP documenting including pro's and con's of each system as a property management solution for the organization.

These points are addressed throughout this report, not necessarily in the order shown above.

The opportunity

This is an important moment in history of the Real Estate Assets Department. READ has been running for years on momentum, an informal management structure, and the determination of a core group of people to get their jobs done. It lacks systems, training, information, and authority necessary to do its job optimally.

The City of San Diego has an opportunity to adopt a portfolio management model and to rebuild its operations in support of that model. In doing so, it would improve customer service, increase financial return from its assets, and position itself to provide superior facilities to City operations. Doing so would require significant investment of time and money. It would also require significant support from customer organizations and from the City administration.

In adopting this model, READ would become a leader among municipal real estate organizations. It would demonstrate the applicability of processes that are well-proven in the corporate and the investment real estate environment, but that have not yet been widely adopted in municipal real estate. There is no existing template that can be applied directly to the department. However, the components exist, and the possibility is there.

Sources of best practices

The City of San Diego portfolio includes a much greater proportion of real estate leased to third parties than is found in most other municipalities or government organizations. The appropriate business model for this portion of the portfolio should be based on practices in investment real estate organizations rather than those found in municipalities. The processes found herein are drawn from the portfolio strategies of real estate investment management organizations and real estate investment trusts.

In municipal governments

The situation facing the City of San Diego is common among municipal real estate organizations. In our research of peer organizations, we found very few that were engaged in active portfolio management, and few with a focus on customer service. Instead, most were concerned with compliance-driven processes, and were not actively managing their real estate. There were exceptions, noted below, in certain practices. However, we found no municipal real estate organization with operations that served as an overall model of best practices.

The lack of modern real estate technology supporting these processes is also common among municipalities. In our research, we found many departments using inadequate systems, and therefore unable to address City real estate issues at portfolio level.

In other governments

We also turned to portfolio management and planning practices outside the United States. England's Audit Commission has promulgated standards for portfolio management that are making their way through the United Kingdom and Canada. More recently, the United States federal government issued similar requirements for all agencies under the Office of Management and Budget. These models are accepted and in use outside the United States, and early responses in the United States are encouraging.

Other sources

Having found few best practices among government real estate organizations, we turned to two other areas to identify appropriate practices for READ. San Diego's portfolio includes both operating real estate and assets leased to third parties providing City income. As such, appropriate models can be found in corporate and investment real estate organizations.

In corporations

Corporate real estate organizations face many of the same issues that concern the City of San Diego - acquiring and controlling the real estate necessary to accomplish the business of the organization, in the most economical and efficient means possible. But corporate real estate organizations are driven by larger corporate structures that enforce standards of accountability, reporting, and decision-making that drive better real estate decisions than are found in most governments. Also, in a corporate environment, funding is more readily available for real estate activities that can enhance overall productivity. Not all corporate real estate organizations are well run, but in general, this area is a source of best practices that can be applied to municipal real estate organizations.

In investment organizations

For the investment component of the portfolio, the largest opportunity lies in bringing READ's practices to the level at which its assets are viewed in a competitive light. At present, the inflexible leasing structure, slow response time, and unpredictable approval processes involved in leasing or acquiring property from the City detract from the potential return to be achieved by these assets. Prospective buyers or tenants quickly turn elsewhere if alternatives exist that can be procured through conventional real estate channels. Thus property is not placed into service, or is only able to achieve a fraction of the economic performance it could achieve on the open market. The City's process of leasing to not-for-profit organizations is particular example of this. An opportunity exists to deploy City assets to achieve both greater good and greater return. At present, the process does not examine the question of how such tenants achieve the City's goals, nor of the economic necessity of such subsidy.

We examined portfolio management and strategy development practices among real estate investment trusts (REITs) and real estate investment managers (REIMs) to identify best practices. These organizations provided well-established practices and methods that are applicable, on a scaled-down basis, to the investment portfolio of the City of San Diego.

Conclusion

The resulting set of best practices is a hybrid coming from municipal practices both in the U.S. and abroad, corporate real estate organizations, and real estate investors. It reflects a dramatic change for the City of San Diego.

Definitions

The following definitions are used throughout this report:

- **READ** – Real Estate Assets Department
- **Portfolio** – all of the City's real estate, including owned and leased property, operating and surplus property
- **Corporate property** – used to house City functions that do not directly provide service to the public, e.g. administrative offices, book depositories.
- **Public service property** – used to provide service directly to the public, e.g. parks, fire stations, schools, libraries, rights of way for utilities
- **Surplus property -** in excess of city needs that is best suited for immediate disposition by sale.
- **Investment property** – properties capable of generating income and best suited for commercial lease or to be held for future use or disposition.
- **Active property –** City property occupied by a user well-matched user, unlikely to change
- **Interim property –** City property to be considered for another use, or held in reserve for a future use
- **Opportunity property** – Sites that are underutilized, or currently not the highest and best use with a higher income potential.
- **Remnant parcel –** parcel of land that remains after a partial taking or easement, and that is not a zoned, buildable parcel
- **IRWA –** International Right of Way Association
- **SR/WA –** Senior Member, IRWA – designation granted by IRWA to members who have achieved professional status through experience, education and examination
- **CCIM** - Certified Commercial Investment Member - a recognized expert in the discipline of commercial and investment real estate
- **MAI** - Member of Appraisal Institute - the commercial designation conferred upon members of the Appraisal Institute, an international organization of professional real estate appraisers and valuation consultants for attaining qualifying standards of education and experience.
- **BOMA –** Building Owners and Managers Association
- **RPA -** Real Property Administrator - a BOMA designation validating a high level of expertise of both third-party and corporate property managers.
- **SLA –** Service level agreement
- **LIBS –** Lease Information Billing System – A proprietary system currently used in READ
- **CORP –** City-Owned Real Property system – A proprietary system currently used in READ
- **"Authority within a box" –** Authority for a department or agency to take action in ways that comply with defined parameters, without obtaining further authorization

Current state

Introduction

The mission statement of the Real Estate Assets Department reads as follows:

"To manage the City's real estate activities for the greatest benefit to the residents of San Diego"

The Real Estate Assets Department of the City of San Diego is in need of a new business model. Until recently, it has functioned in a stewardship role, continuing to apply methods and policies to situations as they arose, without a clear plan. This reflects the broad mandate of the mission statement. The City's large portfolio of income-producing real estate was managed without a formal portfolio plan. Departmental space was provided as needed, without considering use by other departments, availability, or possible changes in the portfolio. In general, the organization lacked the authority to manage its portfolio, and instead made small individual transactions to provide services as best it could.

This is not the way to achieve optimal performance from the City's assets, nor the way to provide optimal customer service. A successful business model must focus on three areas – real estate investment portfolio performance, operating portfolio planning, and customer service.

We describe that business model in the next section of this report. In this section, we discuss the current situation in READ.

Note that, in the months since beginning this report, significant change has already occurred in the group. This has included changes to the organizational structure, reassignments of work, adoption of tools, and steps toward formulation of some of the portfolio plans discussed herein.

People

At present, READ is broken into four functional groups, as follows:

- **Acquisition, valuation and relocation** – primarily focused on acquiring new parcels for City projects, and for managing the relocations of current users of those parcels. This group also includes the appraisal function.
- **Asset management** – responsible for real estate matters on property owned by the City, including that property occupied by the City, as well as City-owned property leased to third parties.
- **Corporate Services**-responsible for the administration and other services performed to provide city-owned space, or space leased from outside third parties, for use as city facilities.

- **Administrative support** – responsible for recordkeeping, word processing, document processing, database maintenance, and bookkeeping

Current State

Structure –the department lacks a managerial and supervisory layer that is necessary under the proposed business model. Many processes call for approvals by the Director, so many that it is difficult for a single director to read and review everything that is signed. This situation will improve somewhat under the new business model, but still requires a managerial layer to the structure. The recent addition of a Deputy Director focused on operations is a substantial improvement, and this role should be retained.

Expertise – about half of the personnel in READ have not worked in another real estate organization, and many have educational backgrounds that are not related to real estate. While they have considerable experience gathered in the course of their work in READ, this group lacks the flexibility and knowledge of real estate technique that comes from working for a nongovernmental real estate organization. Professional training appears to have been limited to offerings from the IRWA, and the SR/WA designation prevails in READ, despite being of limited use outside of the acquisition, valuation and relocation group. At present, 11 of 18 property agents hold the SR/WA designation.

Teaming – In the asset management function, property agents are assigned a portfolio of properties for which they are solely responsible. These are grouped by property and transaction type, and each agent is responsible for maintaining files, records, and negotiations on each property. The lack of redundancy of this institutional knowledge presents considerable risk.

The same lack of redundancy exists in the acquisition, valuation and relocation group. But, given that this group's work is project-based, there is lower risk because of the shorter time frames for its involvement with property.

Peers

At municipal organizations reviewed during our research, we identified the following:

Organization - Most are organized with a similar split between the acquisitions and asset management functions. However, the emphasis on acquisitions and relocation is typically much greater than in San Diego. In many cities, the real estate function falls under the Public Works Department, since its primary mission in those cities is to support ongoing development of City functions. In San Diego, because of the large portfolio of owned investment property, the emphasis is shifted.

Training - We also noted higher levels and outside real estate experience and greater support for training and professional designations in other municipal real estate organization, as follows:

- Dallas – half of the personnel in the real estate function had outside real estate experience

- San Jose – senior leadership in the real estate function comes from the real estate industry
- Port of San Diego – costs and time for CCIM coursework are covered by the employer
- Seattle – costs and coursework for RPA and MAI designations are covered by the employer

Process

Consistent application of functional processes is essential to a successful real estate organization. The level of adoption of standard processes in READ varies by function.

Acquisition, valuation and relocation functions

The work of this function is project-driven, and occurs over a relatively short lifecycle. Many of these projects are also parts of larger project involving other City departments. As such, the processes used in acquisition, valuation and relocation have had both reason and opportunity to evolve over time.

The result is a set of processes that is well-understood, and that is supported by standard forms and methods. These include:

- A formally administered list and categorization of appraisers
- A library of approved forms and agreements, incorporating calculations and methods required by federal agencies
- Consistent timelines and methods applied across the team

Portfolio plans, to the extent that they apply to this group, are generated outside of READ by departments requiring this group's services. To the extent that portfolio planning is necessary in this function, it is driven by the portfolio plans of those departments.

The business model under which this function operates appears to work well for the acquisition and assemblage of small parcels for City projects. It parallels the structure and function of similar departments in other cities, and is built according to models promulgated by the International Right-of-Way Association (IRWA). There has been considerably less satisfaction with regard to its ability to assemble high-value parcels for economic development, and one economic development agency in San Diego no longer uses this group for that function.

Administration function

The administrative support function parallels the functions to be found in other City departments, and its processes reflect that. Overall, its processes are systematic and well-documented. Every other process in READ is affected at some point by what goes on in this function. That includes budgeting, bookkeeping, Service Level Agreement (SLA) compliance, forecasting, lease setup and payroll. Failure in any of these functions has immediate consequences, so over time they have become rigid and reliable.

However, many administrative functions are hampered by the lack of adequate technology. Much of the repetitive work of this function would be rendered unnecessary under a modern set of tools. This includes:

- Re-keying data in forms
- Consolidating forecasts and projections
- Budgeting
- Entering periodic changes to rent
- Generating rent adjustment letters
- Insurance verification
- Time tracking and timesheet enforcement
- Research on portfolio issues
- Payroll

In addition, this group covers reception functions at the front desk, as well as information management and handling public inquiries.

This group's functions and procedures are in place, but inconsistency in other functions combined with reduced staffing levels and the loss of institutional memory have put strains on this group.

Asset management function

It is in this group that processes are the least evolved, and are applied with the least consistency. This arises from several factors:

- Less interaction with other departments – much of asset management's work is conducted entirely in READ, with little feedback from other departments
- Few peer organizations – San Diego's portfolio of leased property poses a management burden that does not exist in other municipalities
- Long asset life – the properties held by READ have been in the portfolio for long time. Most all of the leases and agreements were negotiated under multiple department heads and multiple administrations, and reflect different policies and eras.
- Diverse portfolio – assets ranging from farmland to luxury hotels fall under the purview of this group.
- No project close-out – because of the asset-based workload, projects never really end, so there is no opportunity to compare project results.
- Higher profits- assets in this portfolio tend to have higher potential profit than those found in other City portfolios

None of these provide the repetition and urgency that are necessary for efficient, modern processes to evolve. Interaction with properties, tenants and property information is infrequent enough that it has not made sense to update or abide by processes. The proportion of "special cases" is highest in this group.

As a result, there is little consistency in this group’s processes. Property agents work largely independently, applying pragmatic solutions to situations as they arise. Under this structure, the underlying assets cannot function as a portfolio so much as a collection of individual properties.

General observations

READ runs more like a set of independent contractors than a business. Each property agent is responsible for a portfolio of properties, but the responsibility stops at that level. Upper management does not have the processes or communication necessary to identify issues until they arise. In the absence of a database or a central system, there is no standard method of project management. Some agents and administrative personnel have developed spreadsheets and databases to permit day to day tracking of projects, and provide printouts to keep upper management informed. But this does not create a central view of status, timelines, and timeliness.

Inconsistency - There is no enforced consistency of how work is accomplished in the department. Long-term employees are aware of policy manuals, libraries of forms, and other systems, but there appears to be no expectation that these will be followed.

- No definitive library of legal forms
- Multiple standard forms for leases

The absence of a definitive and enforced policy is time-consuming and creates risk. While the adoption of modern technology, including lease administration and property management tools, can address many of these process issues, is important that old tools be removed, so that users are forced to work with modern processes in a consistent manner.

One notable exception is in the area of creating and maintaining paper lease files. In the absence of modern systems, READ's paper system used for lease and property records is consistent, thorough, and rigorous. Our recent audit confirms this. The existence of this paper database will make eventual migration to modern tools a much easier process.

Communication - Much of the business communication in the department is accomplished on paper. Lease files are kept in paper form, accounting data is transferred via paper forms, and approvals are requested and communicated on paper. This makes information inaccessible, and introduces enormous risk of error.

Apart from paper files, there is no clear path through which a supervisor can monitor issues, progress, or lack of progress within a group of properties. Further, because many users retain files electronically in individual "H drives" on the network, information is not accessible to more than one agent.

Use of Office applications - (word processing, spreadsheeting, databases) in the department demonstrates the following concerns:

- **Inconsistent File structure** - There is no clear structure on the network used by READ that would permit users to share files effectively. Spreadsheets, word processing documents, and other data are stored in subfolders tied to each user, ("the H drive") and organized according to

structures decided by each user. While a common file storage area ("the I drive") exists, it is neither widely nor consistently used.

- **Inconsistent and outdated document formats** – though all users are equipped with relatively current versions of Microsoft Office, many documents are still maintained in WordPerfect. Likewise, though the City database standard is Microsoft Access, much of the analysis of LIBS and CORP is done in Paradox. No support for either of these applications is offered by any central source.
- **"Forms" that aren't forms** - we encountered many paper forms at READ that did not correspond to selections in systems, and that had no benefit of standardization. On occasion, we encountered PDF forms that could not be completed electronically, and required a typewriter.

As a result, situations arise that reduce the City's return on its investment assets, and reflect badly on the City.

- Transactions take long enough to negotiate that appraisals become outdated and must be re-ordered, at additional cost
- Tenants move into holdover status without negotiating a renewal. Which reduces their certainty about the availability of space, and which weakens the City's negotiating position
- Leases and documents can sit in legal review for a long time, in one case as long as 2 ½ years

Document management

The existing property data files in READ are stored in a central library. They are subject to a rigorous file structure, and are carefully maintained so that they remain current and usable. However, they remain an area of risk. They are not backed up, and it is impossible to review them cross-portfolio. As part of migration to modern system, these files need to be converted to electronic form. Scanning projects are already in the prototype stage.

Simply scanning the documents without integrating them in a modern real property administration environment will not achieve a significant change in the effectiveness of the department beyond making the documents more usable. Scanning documents should be part of a larger migration, in which READ will use real property administration tools and real property abstracts for most of their work, and will occasionally refer to the underlying property documents. Links to the electronic version of those documents will exist inside the property administration tool, and may be supported by links from a GIS-based navigation system.

Peers

Electronic document management is not yet routinely adopted among municipal real estate organizations. Real estate investment trusts (REITs) and corporate real estate organizations both have migrated to this environment.

Technology – real estate-specific systems

The technology platform at the City includes routine Office applications, some specialized use of GIS, and some customized database programming. Here we focus on the two real estate-specific applications used in READ.

CORP and LIBS

At the core are two key components:

- LIBS (Lease Information Billing System) – containing lease assignments, payment information, and the status of collection and application of payment.
- CORP (City Owned Real Property) – essentially an index of limited information on the portfolio.

By any measure, LIBS and CORP are outdated and insufficient. Both are mainframe applications, running in terminal emulation mode on PCs. As a result, few personnel in the group know how to use them.

Most users work with data from these systems in the form of an Excel export file that is prepared weekly and saved on the shared network drive. CORP and LIBS databases are small enough that (by modern standards) they do not require a mainframe to host them. The only advantage to maintaining them in a mainframe is that it ties to the City's accounts receivables system, so that property agents can get relatively current information about payment status.

Though these systems are computer-driven, much in the process is not automated. Lease setups, fixed assets, and forecasting are all transmitted to core City accounting systems on paper. Likewise, the tickler systems, budgeting processes and forecasts all include steps that involve paper, pen, and re-keying of data. The projection process alone reportedly takes one person four months of effort.

Technology in management

CORP AND LIBS hampers day-to-day READ operations in several ways:

- **Weak event reminders (ticklers)** – while the system can generate ticklers, they are paper-based and distributed without any consolidated report. This makes many of them nearly useless for prioritizing work or monitoring progress
- **Limited lease setups** – the system cannot accommodate more than one future change in rent levels. Thus, if a lease has multiple changes during its term, this requires agents to revisit the lease at each modification. This is much less efficient than setting up the lease all at once, while it is still fresh in the minds of all parties.
- **No record of communications** – when agents communicate with landlords and tenants, recordkeeping is in whatever form used by the agent, and is not in CORP and LIBS. There is no possibility for other agents or supervisors check these records, nor are there any standards for how such records are kept.
- **Informal correspondence files** – there is no electronic record of correspondence relating to leases, other than word processing files kept in individual folders.

- **Insufficient data** – The systems contain only the most basic data for each property, sufficient to use as an index for paper files. Very little can be accomplished without referring to files.

Both LIBS and CORP data reside in a mainframe system that dates back twenty years or more. Its longevity speaks to its reliability, security and structural integrity, yet most agents find it, at best, cumbersome and difficult to work with. Maintaining this system has also become a user-friendliness issue for new hires and transfers that are used to a modern data management system. At present, there is one person who knows the system well enough to use most of its functions, but even that person chooses to export the data to a more modern system (Paradox).

Usability

While the system is functional, it lacks several features that make its data usable.

- Drop-down lists – Confirming the use of approved descriptions, so a property may be described as a nursery, or simply "trees"
- Field Validation – to confirm that a field contains appropriate data, so that the same field doesn't contain acreage for one property, and square footage for another.
- Windows application conventions, such as cut, paste, spell-check, and formatting
- Large number of people trained in these applications
- Standard user interface, not driven by code numbers

Without these, property-by-property data may be usable, but analysis across a portfolio is nearly impossible. Symptoms arising from these outdated systems include the following:

- During eviction processes, there is no way to prevent rent checks from being deposited, though this can jeopardize a successful eviction.
- On occasion, tenants have better information about rent adjustments than is found in the system.
- Many leases are not reviewed until they are very near expiration.

Replacing these systems is central to solving the organizational and process challenges facing READ, especially in the asset management and administrative support areas. The presence of modern systems creates communication, accountability, time savings and reporting capability that are crucial to this department.

Peers

Municipalities

Use of technology in municipal real estate organizations is not very far advanced. Only a few have adopted electronic document management, and none that we interviewed had installed a fully-developed property management system. This may reflect differences between San Diego's portfolio and that of most cities (San Diego has more owned property leased to third parties) but it also reflects the relative lack of emphasis on real estate in other City governments.

Even so, other municipal departments included practices that should be adopted in San Diego:

- Greater use of databases – routine creation of databases in Microsoft Access for property listings, lease administration, and surplus property inventory
- Greater use of web sites – listings of surplus property, identification of key contacts, and publication of standard forms to be used on City real estate deals
- Creation of standard libraries of forms, in a shared environment on a central network

Corporations

By contrast, corporate real estate organizations were considerably further ahead in their adoption of real estate-specific technology. This may stem from greater revenue pressure, or from larger and more uniform portfolios of property. For the most part, corporate real estate organizations had created customized versions of real estate applications, with strong linkages to core accounting systems. The multiple thousands of income-producing assets, and related accounting work, made this cost - effective.

External communication

External communications are essential to READ's role as a customer service organization. At present, other than annual reporting and responses to requests, READ does not deliberately communicate information about the department, its functions, its portfolio, and necessary procedures to work with READ. Its web presence is limited to information on RFPs, and departmental contacts, and little else. Visitors to the department are not greeted by a receptionist, and the department has very little visibility.

Asset management

Historically, the asset management function has maintained contact with its major internal customers, the Water department and the Wastewater department, through designated single points of contact for each group. These people were responsible for regularly scheduled meetings, preparing reports, and identifying status on issues. The personnel filling those roles are no longer with READ, and the roles are now filled by teams of people. This form of communication is in the process of being reestablished, with regularly scheduled meetings.

However, there is no formal process for communication with tenants on matters such as renewal, lease changes, and compliance. Apart from a tickler system, there is little formal or scheduled communication. Incoming communication from prospective tenants is even more difficult, given the absence of a receptionist and a clear means of communicating who is responsible for which properties.

Acquisition, valuation and relocation

The City agencies served by the acquisition, valuation and relocation function are repeat customers, working on a project basis. For this reason, the internal communication on these projects is relatively effective.

Performance measures

The organization and technology in use at READ do not support the creation and monitoring of appropriate performance measures. The amount of effort required to analyze the portfolio, transactions, timeliness, economic performance, and customer service is such that very little formal analysis can be conducted. Instead, performance reviews and performance measures are based on anecdotal data, summary reports prepared prior to annual reviews, and compliance-driven reports. (A notable exception is the recent audit of data quality in READ's databases.)

Because of this, the performance of the organization has not been focused on achieving superior portfolio results, superior customer service, or overall strategic goals. In discussions with property agents the primary performance measure mentioned was leases per agent, without adjustment for property type, expiration schedule, or scale. Beyond this, we identified analyses of leases in holdover, and a preliminary analysis of not-for-profit tenancy.

Peers

A review of other municipal real estate organizations revealed the following performance measures:

- Monthly feedback by staff of other departments
- Client surveys on staff performance
- Las Vegas – Monthly report on upcoming lease events ("Red Report")
- Dallas- MS Access-based query system for performance management – to track transaction volumes (with a goal of 50 transactions/year/person)
- El Paso – Distributes reports to a CARE committee that extends outside RE to the City Manager (mostly focused on surplus property)
- El Paso – also measures surplus property both sold and returned to the tax rolls.

Authority and governance

The authority under which READ functions is distributed and confused. It works under accommodation of its own limited authority, irregular and nonsystematic requests to City Council, and responding to real estate actions taken by other City departments.

City Council authority

Many real estate actions require City Council authorization. These include the following:

- Leases longer than three years
- Declaration of surplus property
- Sale of property
- Acquisition of property

City Council actions require approximately two months of lead time, causing tenants and buyers to seek alternative property rather than wait for definitive City Council action. To expedite transactions, property agents craft transactions in ways that do not require such action. This results in short-term leases to tenants that would prefer long-term, and the use of leases rather than sales.

At present, City Council considers real estate actions as they arise. There is no formal real estate schedule agenda. If the City is to migrate to active portfolio planning as discussed later, the City Council calendar will include regularly scheduled meetings at which portfolio plans and modifications to "authority within a box" are considered and acted upon.

Sources of authority

Authority for real estate transactions is spread across multiple areas at the City. In particular, authority exists in the Parks and Recreation Department, the City Manager's office, and the City Council. Also noteworthy is the absence of the final authority on certain key issues, especially on matters of interdepartmental real estate. Authority stems from several areas:

San Diego City Charter

- *sect. 53 Water Utility* - sets up the Water Utility and Water Utility Fund
- *sect. 55 Parks and Recreation* – The City Manager shall have control… of the parks…. All real property… formally dedicated… shall not be used for any but a park or cemetery purpose…. However, real property… set aside without the formality of an ordinance or statute dedicating such lands for park, recreation or cemetery purposes may be used for any public purposed deemed necessary by the City Council.

This, in effect, grants authority for real estate decisions on non-park property in the department to that department.

Municipal Code Article 2 Division 15 Park and Recreation Department

- sect. 22.1501 Park and Rec. Director – …director shall have charge of all activities within the Park and Recreation Department….
- sect. 22.1502 Director – Powers – …subject to the approval of the City Manager.... the Parks and Recreation Director shall also have the authority… to fix rental charges, to negotiate leases….
- sect. 22.0201 Authority, Department Organization – The City Manager shall have authority within any office or department … may assign work to them, as may be necessary or convenient for the proper conduct of the work of the office or department.

These jointly create authority with Parks and Recreation to undertake leases.

City of San Diego Council Policy (700-12) Disposition of City Property to Nonprofit Organizations

- "…City's practice {is} to lease… City property… to nonprofit organizations at less than fair market rents to provide recreational, educational and cultural enrichment and other services.

This is policy, and can be changed. It is exceptionally broad, and gives significant discretion as to the extent to which such leases may be below market. It also does not distinguish between such organizations, and applies only the criterion that they be nonprofit, without further considering their goals and mission.

Notable absences

We found nothing that required any level of real estate expertise in agencies that are authorized to execute real estate transactions.

Effects

As a result of distributed authority, real estate decisions are being made that do not make economic sense. Examples include:

- Mismatches between short-term responsibility and long-term asset holds (long leases signed for short needs)
- Space leased without taking advantage of inventories of vacant space
- No uniform rental rates – actual rents by building are charged to the occupying departments
- No central planning of tenant improvement allowances offered by landlords, resulting in inconsistent and poorly-maintained space

Peers

In municipalities

Our survey research revealed that in most other cities, real estate authority is concentrated in the real estate department. This appears to reflect the unusual nature of San Diego's portfolio – it owns many more properties than do most cities, by virtue of Pueblo lands. For this reason, in other cities, the real estate function is often part of the Public Works Department, and focuses on real estate related to roads, fire houses, public buildings, and other ongoing public uses. In other cases, such as San Jose, the real estate group has a formal role as technical advisor to the City Council. Other findings were as follows:

- Limitations on authority to transact outside of the real estate group
  - In San Jose, only airports (which can lease runway tie-downs) and the Housing Department can negotiate their own transactions
  - In Las Vegas the Economic Development Department can negotiate and execute real estate transactions without the department's help or authority
  - In Seattle, agencies can bypass the real estate function, but must go through City Council to do so
  - In Houston, no real estate transactions can be negotiated or executed without real estate department involvement and approval
- Location of the real estate function
  - In Dallas, real estate is under the Development Services group
  - In other cities, real estate is under public works

Nonprofit leasing

On the subject of leasing to nonprofit organizations, we found little if any clear policy in other municipalities. None had a portfolio of surplus property like the one found in San Diego, so the question had not been given the same level of attention that it has in San Diego. A notable exception was in Austin, Texas, in which idle City property was made available first for housing use, and thereafter for other uses. In that market, every piece of available real estate had been put to housing use, so the remaining processes had not been tested.

In corporations

Successful real estate departments in corporations are responsible for the real estate aspects of all portfolio decisions. They develop and live within a portfolio plan, and work with senior management to align this plan with overall corporate strategy. While operating departments may be responsible for identifying property as surplus, or for estimating demand for facilities, the sale of that property or leasing of that space is in the purview of the real estate department.

In investment organizations

For real estate investment organizations, whose primary focus is the execution of a real estate strategy, authority is broken down further, into committees for each aspect of that strategy. Specific committees are formed for acquisition, disposition, and periodic adjustment of strategy. These organizations set the parameters under which asset managers make a day today decisions about leasing and operations.

Desired State

In this section, we describe the desired state of READ, including processes, structure, technology, performance measures, and other elements needed to fulfill its mission. This represents an optimal vision of the department, without constraints.

Mission

As discussed earlier, the mission statement of READ is too broadly phrased to guide READ's operations. Based on our interviews and review of the group, a more useful statement would be as follows:

"The mission of READ has three major components:

- *Acquire and manage real estate required for government functions and services*
- *Generate revenue through leasing and sales of surplus assets, and*
- *Maximize the overall financial return on the City's real estate portfolio"*

A clear mission is important as a test for evaluating action. If a proposed action does not lead directly to fulfilling the mission of the organization, it should not be undertaken.

Portfolio plan

A formal portfolio plan is at the center of our recommendations for the desired state for READ. This portfolio plan is presented to and approved by City Council on an annual basis. It includes the following:

- A review of the portfolio
- An operating plan for corporate property
- An investment or disposal plan for surplus property
- Market research and specific parameters for anticipated transactions in support of these two plans
- Request for authority to act within those parameters

Once it is approved, the plan constitutes "authority within a box" to conduct real estate transactions within its parameters, without seeking further council action. For READ, this would mean the consolidation of many individual processes and actions into a periodic portfolio plan that would be presented to City Council on a regular basis. The processes supporting this review are based on management by exception, and focus on anomalies in the portfolio and on adjusting general thresholds.

The execution of this portfolio plan is a large part of the business of READ. It does not include acquisitions or relocations, but it covers most everything else.

A proposed outline is as follows:

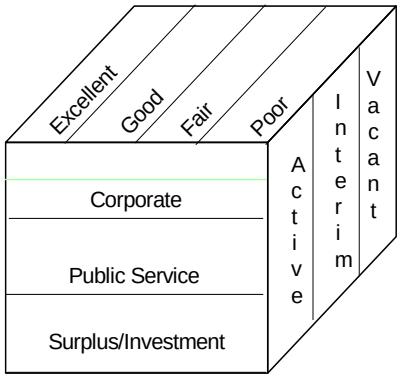
Portfolio plan outline

1 - Portfolio overview

The report begins with overview of the real estate held in the city.

Definitions of classifications

- Purpose (Corporate, Public Service, Investment/Surplus)
  - Corporate – used to house City functions that do not directly provide service to the public, e.g. administrative offices, book depositories, storage areas, service yards etc.
  - Public Service – used to provide service directly to the public, e.g. parks, fire stations, schools, libraries, rights of way for utilities
  - Surplus / Investment – All other property
- Status (Active, Interim, Vacant)
- Condition (Excellent to Poor)
- Highest and Best Use (Maximized, Underutilized)



This section presents a summary of the portfolio, expressed in pie charts and numerical tables.

- By purpose – corporate, public service, surplus/investment
- By condition, graded from poor to excellent
- By status, including active, interim, and vacant

Portfolio plans

Next is a set of portfolio plans for each major component of the portfolio. All follow this general outline:

- Portfolio review
- Upcoming events
- Market research
- Anticipated results / plans
- Request for action

Specifics are as follows:

2 - Acquisition / relocation portfolio plan

Portfolio review

- Review of holdings in process
- Review of upcoming projects scheduled
- Departures from schedule and holdings greater than one year
- Calls for action as needed

3 - Public service portfolio plan

Changes in the composition of this portfolio are not likely to be initiated in READ, and will likely to be dictated by departments outside of READ.

- Review of current holdings
- Summary of changes since the prior year
- Proposed changes to the portfolio (summarizing requests from other departments)
- Market research and estimated pricing parameters for executing those changes
- Request for authority to execute transactions in line with those parameters

4 - Corporate portfolio plan

This portfolio consists primarily of office space.

Portfolio review

This is a review, building by building, of every space occupied by this function.

- Condition
- Cost, total and per square foot
- Upcoming events (lease expirations, renewal options)

Demand review

- Occupancy, by building and floor
- Stacking plan, by building and floor, with key data for utilization by employee
- Anticipated demand, by department and floor

Portfolio response

- Market Research – Market and actual cost for any building with an upcoming event
- Recommended actions – Expansions, contractions, new development

Request for action

- Request for authority to execute leases within parameters set based on market research

5 - Surplus / Investment portfolio

Portfolio review

- Broken down by property type (farmland, telecommunications tower, hotel)
- With performance data for each major property or group of properties

Upcoming events

- Leases approaching expiration
- Leases requiring action
- Properties identified as surplus

Portfolio RESPONSE

- Market research
- Recommendation of monetization strategy (sale or lease)
- Recommended pricing

Request for action

Request for authority to execute within described terms

- Sale of surplus property
- Execution of leases within terms (authority within a box)
- Designation of properties as surplus

6 - Not-for-profit portfolio plan (subset of surplus / investment portfolio)

Portfolio review

Summarizing several areas:

- Aggregate value of properties leased to not-for-profits
- Aggregate rent collected on those properties
- Cost of providing landlord services to tenants
- Aggregate value of City costs alleviated by tenants
- Change over the last year

Upcoming events

- Review of leases with upcoming expirations, holdovers, month-to-month tenants
- Historic rent, subsidy, and value of services for each

Portfolio response

- Proposed renewal / non-renewal action
  - Measure of proposed subsidy for each new deal
  - Summary of business case for each new deal
- Proposed re-characterization from Not-for-profit to surplus

- Revisions, if any, to the guidelines for eligibility to lease City property under subsidy

Request for action

- Adjustment of eligibility criteria as needed
- Authority to execute leases that comply with parameters

In the following sections, we lay out the major READ processes and how they are incorporated in, and affected by, the portfolio plan.

Major elements in developing and administering the plan

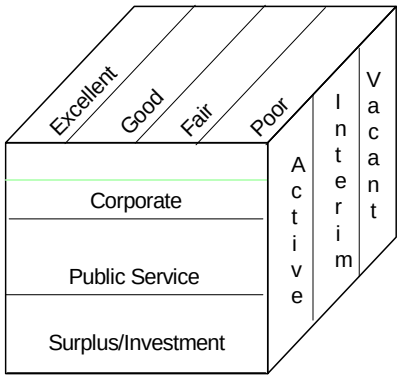
We have identified several major processes to be adopted under a best practices model. Some are full processes, and some are detailed some components of other processes. They are discussed below, and are as follows:

- Property evaluation and characterization
- Occupancy strategy development
- Surplus / investment portfolio plan
- Not-for-profit portfolio review
- Business case development
- Supporting structures
- Legal document development and review

Property evaluation and characterization

One key process is the evaluation of every property in the portfolio. This starts with a cataloging process, but also involves characterizing properties as to their fitness for purpose, physical condition, and utilization. Based on the conclusions reached in this characterization, each property is assigned a status that determines the processes applied to it thereafter.

The categorization of properties in the portfolio involves multiple attributes for each property. While it is tempting to apply a hierarchy, the analysis and management of the portfolio may include combinations of attributes that do not fit such a hierarchy. It is more appropriate to categorize properties along multiple attributes, as shown.



Data gathering

For the property evaluation, data can include the following

Physical characteristics – size, location, condition

This includes information gathered from the most recent inspection of the property, and drawn from files.

- Size – acreage, square footage, capacity
- Characterization of improvements – construction type, age, quality
- Physical quality –class A, B, or C
- Physical condition – usable, in need of repair, unusable
- Land quality – geology, soils, drainage, and others depending on highest and best use of the site
- Permitted uses – community plan conformance, special districts
- Zoning- conforming use for the zoning category.

Purpose / condition / status

- What is the property used for?
- Is the property usable? Does it require work or cost to make it occupied or usable?
- Is it occupied?

Utilization

Utilization information is derived from the ongoing management of the property.

- City-occupied facilities – departments and personnel housed, workstations installed and occupied, vacancy and square footage per person or workstation
- Parkland – acreage, visitors, utilization statistics, days reserved/vacant
- Agricultural land – revenues, crops planted, water requirements, and other productivity measures
- Municipal service buildings – relevant measures and ratios, possibly including fire engine counts, personnel counts, area served, and other measures to compare across the City portfolio
- Investment office space (leased to third parties) – occupancy/vacancy, gross and net revenues per square foot
- Vacant land – adjacent uses, maintenance requirements and burdens, history of most recent use

Fitness for purpose

This attribute considers the suitability of the property for its trade use. (Note – this is most applicable for corporate and public service properties).

- Built for this purpose? – i.e. fire station operations in a firehouse vs. office operations in an industrial building
- Appropriate location – is the property near the people it serves, or the departments with which it works?
- Size – how well does the function fit in the property?
- Physical configuration – does the shape and layout of the property correspond to the function carried out in it? This includes parking, workstations, customer service areas, and other specific features

For certain groups of properties, this part of the analysis is very simple. For public infrastructure property, designated open spaces, and special-purpose properties, the input as to fit for purpose will come from the department utilizing the property.

Cost/value

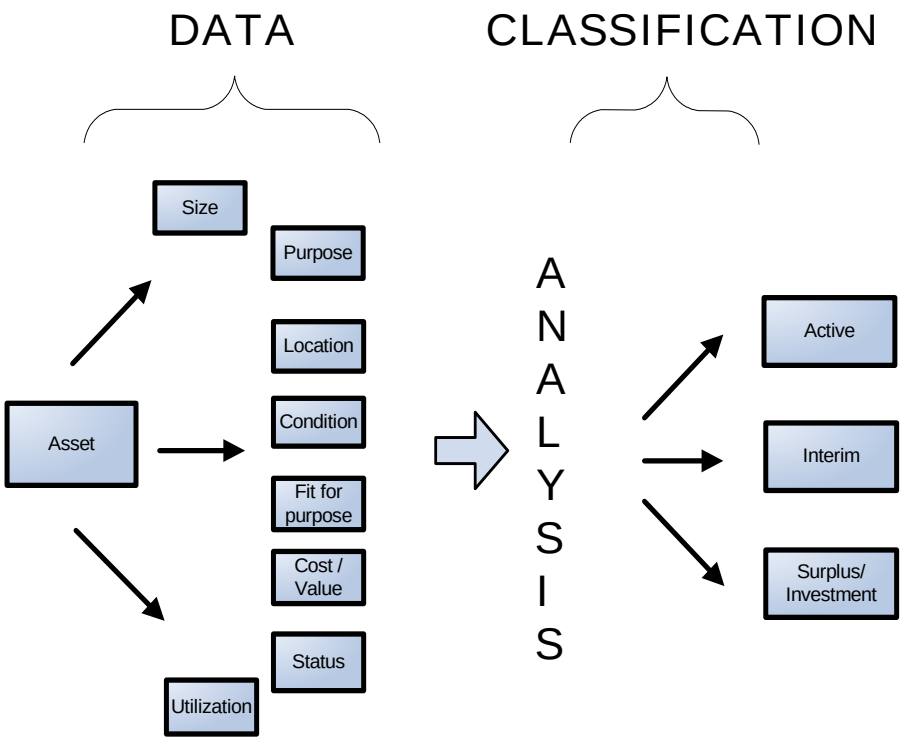
Valuation measures vary depending on the property type being considered. Common elements include:

- Highest and best use – disregarding current use, what uses most likely to achieve maximal value for the property, based on surrounding uses, market trends, site and building characteristics, zoning and other restrictions
- Market value – again, disregarding current leases or contractual obligations. Based on appraisal, comparable sales, market offerings, or appropriate analysis of other properties in the portfolio
- Market rent – appropriate measure of return based on highest and best use, and using the same terms under market value
- Contractual rent – if the property is under lease, the income stream under that lease

Determining status

An appropriate committee within READ conducts a review of the portfolio, rather than the individual properties. Working with the database of property, sorted by category in each major dimension, this committee places each into one of three major categories – active, interim, or surplus / investment.

- Active – a good match between property and function, unlikely to change
- Interim – to be considered for relocation of the function to another property with a better match, or held for future use
- Surplus / Investment – property unused by City functions



The first time this review is conducted, it considers every property in the city portfolio. Thereafter, it focuses on those properties whose characteristics have changed, and which may be appropriate for a change in status between active, interim, and surplus.

A second review is also appropriate, pertaining to the necessity of action. This reflects the need for activity due to characteristics of the real estate, rather than to the match between property and user.

Based on this review, it sets a status for each property, in one of three categories:

- Active
  - Good fit for purpose
  - No upcoming events
- Interim
  - Poor fit for purpose, but in active use, or
  - Good fit, with upcoming events, or
  - Underutilized or in an inappropriate use, or
  - Held for future use
- Surplus / Investment
  - Not in City use
  - Held for investment, or
  - To be sold

The result of this process is a database populated with characterizations of each property, which can be used in ongoing portfolio review.

Elements of a portfolio plan

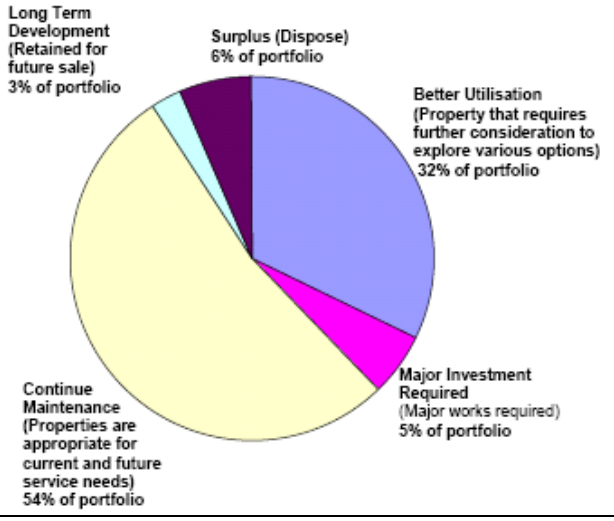
Within the portfolio plan, this section presents

- portfolio overview, broken down by classification, in summary form
- Properties whose status has changed since the last portfolio plan
- Changes in the composition of the portfolio since the last portfolio plan

This section of the portfolio plan presents an overall breakdown of the portfolio by classification, condition, utilization, and economic performance. Examples from other documents are shown below:

Example - Overall portfolio view and recommended actions

Figure 6.0 Profile of the County's property portfolio



[1]

Example - Office portfolio view – condition review

1(a) Percentage of gross internal floor area in condition categories:

A – Good, and is performing as intended
B – Satisfactory, and is performing as intended but with minor deterioration
C – Poor, shows major defects and/or is not operating as intended
D – Bad, where life has expired or is in risk of imminent failure

		Cambridgeshire County Council				Averages from IPF	
						National average	Regional average
	Year	2002	2003	2004	2005	2005	2005
1(a)	A Good %	16	17	16	16	30	9
	B Satisfactory %	74	74	74	74	48	53
	C Poor %	7	8	8	8	20	22
	D Bad %	3	2	2	2	2	16

[2]

Example – Portfolio review – maintenance status

[3]

[1] http://www.cambridgeshire.gov.uk/NR/rdonlyres/F87A36BC-8CF7-47F2-B5F0-3CFD68E20F22/0/060811RefreshCorpAMP20062011.pdf'

[2] http://www.cambridgeshire.gov.uk/NR/rdonlyres/F87A36BC-8CF7-47F2-B5F0-3CFD68E20F22/0/060811RefreshCorpAMP20062011.pdf

[3] http://www.sc.doe.gov/SC-80/sc-82/documents/oecm.ppt#505,14,F&I Summary Statistics

Example – Overall asset values

Statement of Assets held by North East Lincolnshire Council

Category	Assets	Value at 31/3/03	% to Total Value
Land/Buildings - Operational	**473**	**£221,760,000**	**88%**

Examples of Operational Assets

Administrative Offices	45	Libraries	12
Allotments	12	Museums	2
Car Parks	39	Public Conveniences	21
Depots	6	Residential Homes	7
Education – (Adult)	3	Storage Facilities	12
Education –(School)	92	Supported Housing	5
Enterprise Centres	8	Youth & Community Centres	28
Leisure Amenities	20		
Leisure Facilities	51		

Community	**151**	**£277,000**	**0%**

Examples of Community Assets

Civic Amenities	4	Leisure Amenities	46
Parks & Land	38	Leisure Facilities	2

Non Operational - General	**453**	**£27,720,000**	**11%**

Examples of Non Operational Assets

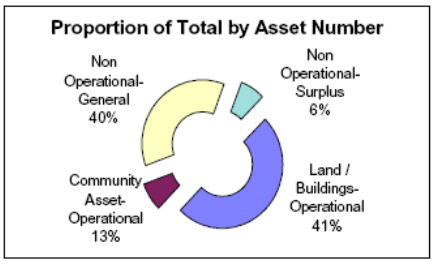
Agricultural Land	5	Mooring Rights	2
Ground Leases	87	Offices	22
Residential Houses	24	Public Houses	4
Industrial Ground Leases	175	Public Services	9
Land	5	Shops	48
Leisure Facilities	24	Surgeries	2
		Small Commercial Units	28

Non Operational - Surplus	**64**	**£2,243,000**	**1%**

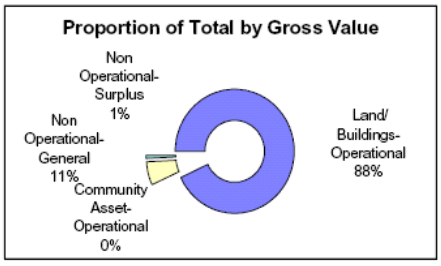
Examples of Non Operational - Surplus Assets

General Buildings	4	Land	11
Depots	3		

Proportion of Total By Asset Number



Proportion of Total By Gross Value



[4]

[4] http://www.nelincs.gov.uk/NR/rdonlyres/E17734F6-E292-47D6-B4B6-261F70B9A139/0/AssetManagementPlan03.pdf

Example- Portfolio condition by floor space

Table 3 - Performance Indicator 1A – Percentage of Gross internal Floor Space in Condition Categories A-D

% internal floor space in condition categories A-C	Condition Category A-C		
	A = Good	B = Satisfactory	C = Poor
2001	1.00%	86.00%	13.00%
2002	1.00%	86.00%	13.00%
2003	3.45%	71.18%	25.36%
2004	5.00%	70.93%	24.07%
2005 (Target)	6.70%	69.80%	23.50%
2006 (Target)	6.70%	71.30%	22.00%
2007 (Target)	7.00%	74.00%	19.00%

[5]

Example – Priority and status of maintenance for operating real estate

[6][7]

Ongoing operating portfolio review

From the adopted portfolio plan, READ conducts the portfolio review on an ongoing basis. The process shown here is drawn from practices that are now established in the U.K. and Canada. The move to adopt them is driven by England's Audit Commission, which has created pressure for responsible portfolio management akin to that created in corporate America by Sarbanes-Oxley legislation. The processes created and used in the U.K. are making their way to the United States, most recently in the form of a White House Executive Order mandating asset management planning for all departments. Very little has been done in the U.S. at the Municipal level, but the State of Oregon has already created its asset management plan, and the City of Seattle is investigating its practices.

The version shown here is adopted from one created by the City of Hamilton, Ontario. We have added a dimension to accommodate the ability to lease surplus property to third parties.

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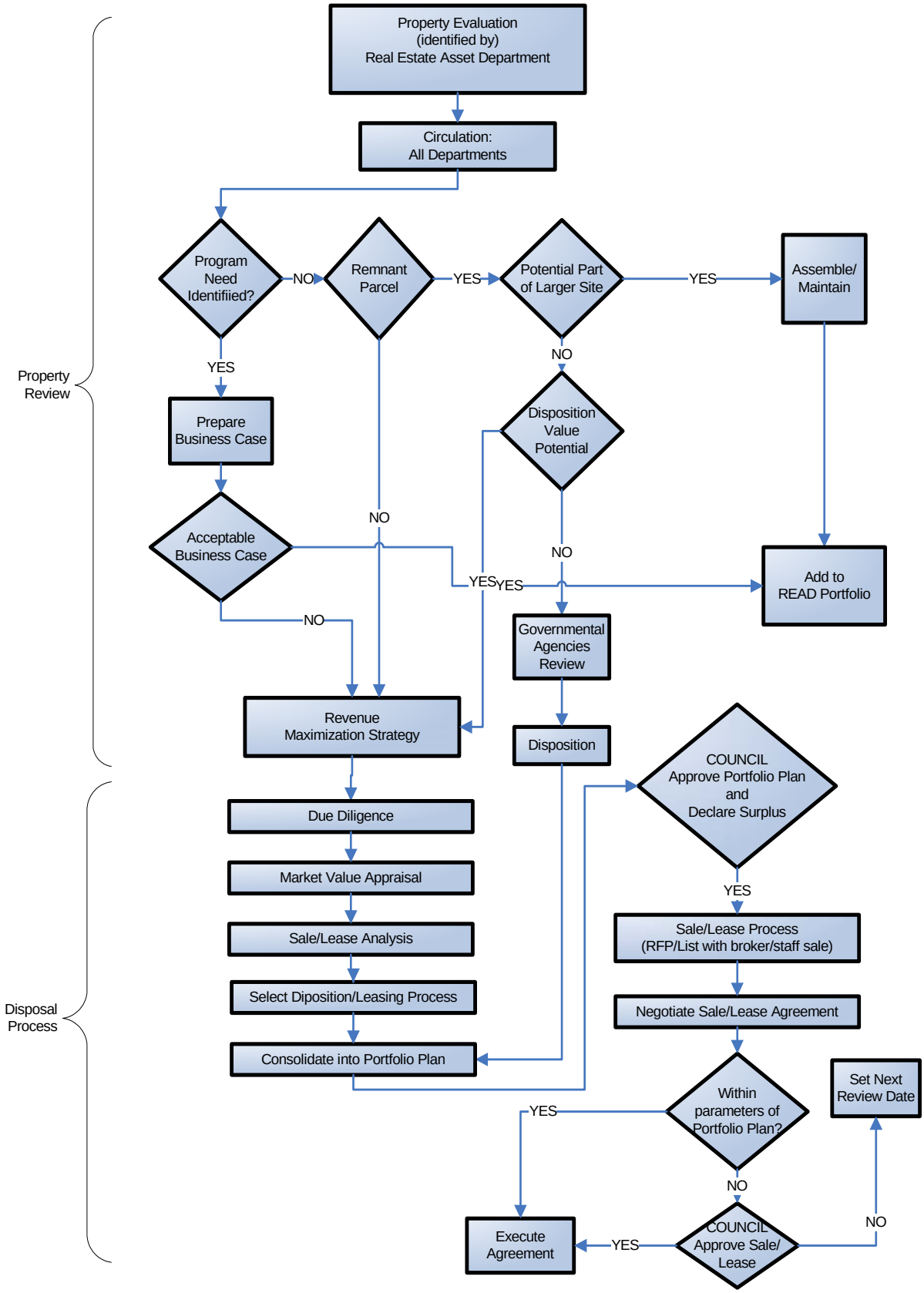
[5] http://www.nelincs.gov.uk/NR/rdonlyres/EB004C49-4829-4E58-A9DC-0C794F73CD9C/0/CapitalStrategyAMP0506.pdf

[6] http://www.wakefield.gov.uk/NR/rdonlyres/C50C0E91-67D1-4657-AE48-7C868C4F4479/0/Assett_Management_Plan_200609.pdf

Ongoing portfolio review – detail



Next, a listing of all properties identified moving from Interim to Surplus / Investment is circulated to all departments. Departments then identify whether they need the property. If so, they prepare a business case, described later.

Properties that draw no interest from city departments are divided into two groups. For remnant parcels, the properties are evaluated for assembly with adjacent parcels or sale as single parcels. For buildable parcels, the revenue maximization strategy is applied.

Corporate

Occupancy strategy development

Another key part of the portfolio plan concerning operational facilities is the Occupancy Strategy. That strategy addresses how the City occupies its space, how will act in expanding changing, or contracting the portfolio of space, and how and why departments are located in parts of the portfolio.

This strategy applies primarily to those components of facilities that are in downtown property, and that lend themselves to periodic restacking and rearrangement.

The occupancy planning process

Steps in the preparation of this part of a portfolio plan are as follows:

- Data-gathering, including:
  - **Utilization data** – gathered at the departmental level, including headcount, workstation type, space requirements, and other data normally gathered in the business case process
  - **Portfolio data** – including space supply, term of leases, ownership status, and costs, as needed to project feature supply and estimate the effects of changes
  - **Market data** – rates and prices necessary to estimate the effects the adding, changing, or removing property
  - **Departmental changes** – information about initiatives that would change in demand, supply, or desired identity of space
- Analysis, focusing on
  - Eliminating redundant use of space
  - Improving functionality of existing space and of departments
  - Improving customer service
  - Reducing cost and utilization of real estate
  - Identifying vacant and underutilized areas
  - Consolidating and centralizing
- Recommendations
  - Long-term plan for changes to the supply of space

- Short-term (one year) specific recommendations for changes in space supply (exiting, expanding, or changing)
- Re-stacking plans
- Capital and renovation plans

As part of larger portfolio plan, the approval process will include authorization to act on those items occurring in the first year, and approval of the long-range strategy.

Elements of the portfolio plan

Portfolio Review

This is a review, building by building, of every space occupied by this function.

- Condition
- Cost, total and per square foot
- Upcoming events (lease expirations, renewal options)

Demand Review

- Occupancy, by building and floor
- Stacking plan, by building and floor, with key data for utilization by employee
- Anticipated demand, by department and floor

Portfolio Response

- Market Research – Market and actual cost for any building with an upcoming event
- Recommended actions – Expansions, contractions, new development

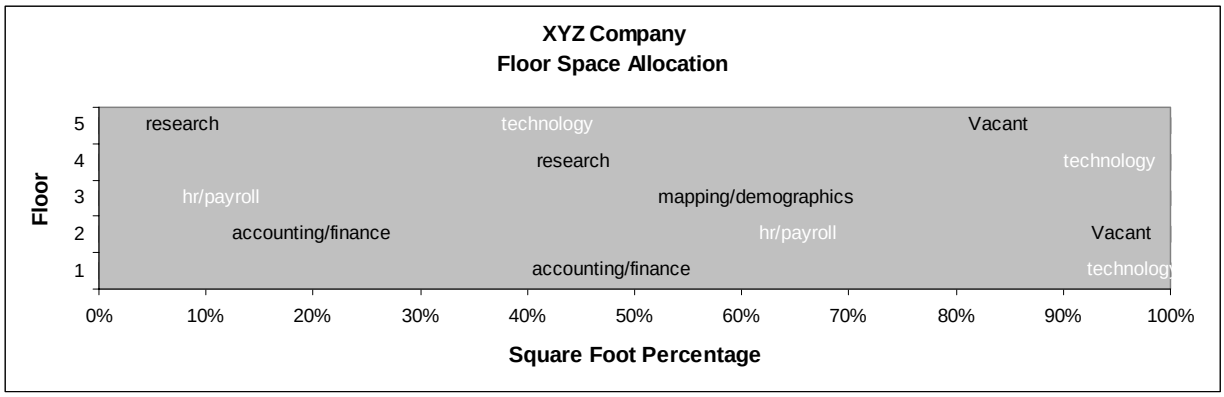
Request for action

- Request for authority to execute leases within parameters set based on market research

Following are examples of graphics used in such plans:

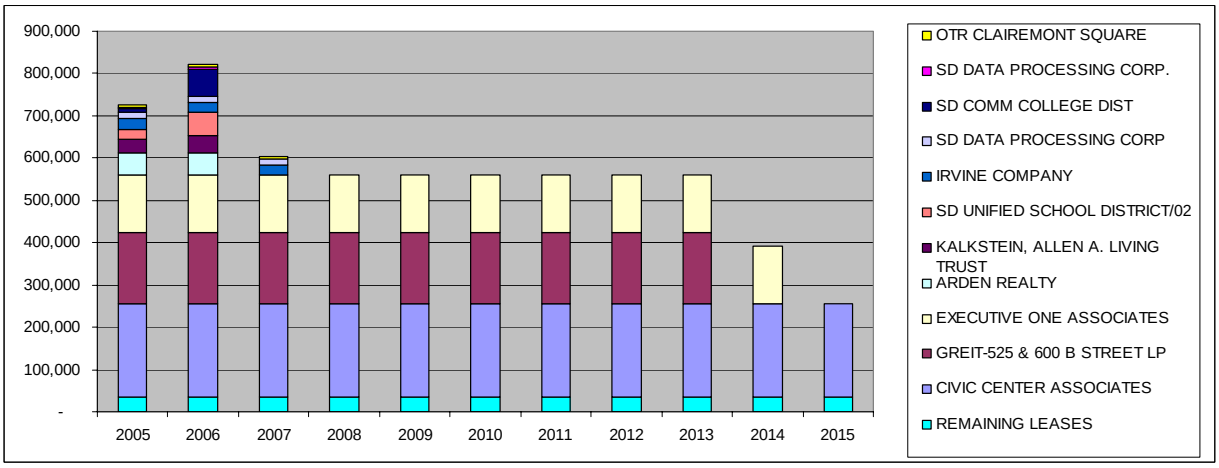
Stacking plan

These charts represent the departments or personnel on the floor-by-floor basis. They can be used to represent current occupancy or proposed restacking. This example is from a corporate real estate organization.



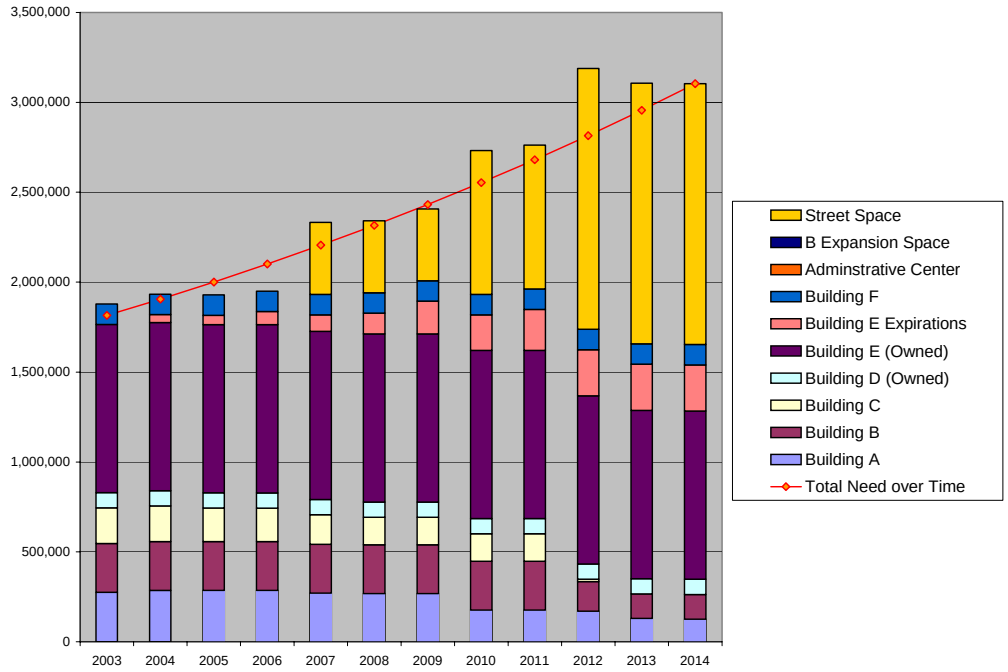
Lease obligation view

This is a graph, over time, of facility space under control through leases or ownership. It is the first step in identifying a long-term portfolio response to demand for space at the City. This example was generated using rough lease data from the City of San Diego.



Comparison of supply and demand

The following graph depicts the supply and demand for facility space in a corporation. Over time, it shows consolidation of space from multiple small sites into several larger ones. This is a useful tool for showing how an organization will respond to changes in demand over time. In the chart, individual properties are represented by blocks, and the red line represents the total demand for space across all departments. The goal is a plan under which the line stays below the stacked bars, but near the top. This represents near-complete utilization of facilities, without waste. In the event that the lines are higher than the bars, there is a shortage of space.



Other occupancy strategies

Discussion and planning of any property type requires specific data. Given the diversity of the City's portfolio, the data necessary for decision-making vary considerably. In this section, we review some of the specific data requirements for each property type.

Potentially centralized functions – corporate portfolio

In some cases, functions can be centralized, and are found in remote locations due to the availability of space, or because of past decisions. Any analysis of the overall space portfolio should include them in terms of consolidation opportunities. Specific situations include exiting leased property and moving to owned property, or relocating from high-cost markets to lower-cost markets.

Non-centralized functions – public service portfolio

The property housing certain City functions does not benefit from centralization, or are required to be near particular parts of the city. These fall under the grouping of Public Service, and include parks, fire stations, local service offices, and others. For these, the process of real estate strategy is one of ongoing review. Elements of that review include:

- Physical condition - level of deterioration, suitability for purpose, and necessary repairs
- Facilities cost – for the entire facility, and expressed in appropriate units for the services delivered (e.g. cost per square foot, cost per fire truck)
- Level of utilization – as appropriate for departmental function
- Alignment with departmental planning – does this property fit the occupying department's plan for delivering services? If not, when is this facility likely to close?

- Issues for potentially closed properties
  - Highest and best use – especially for properties that are likely to become available
  - Market value – especially for properties that are likely to become available

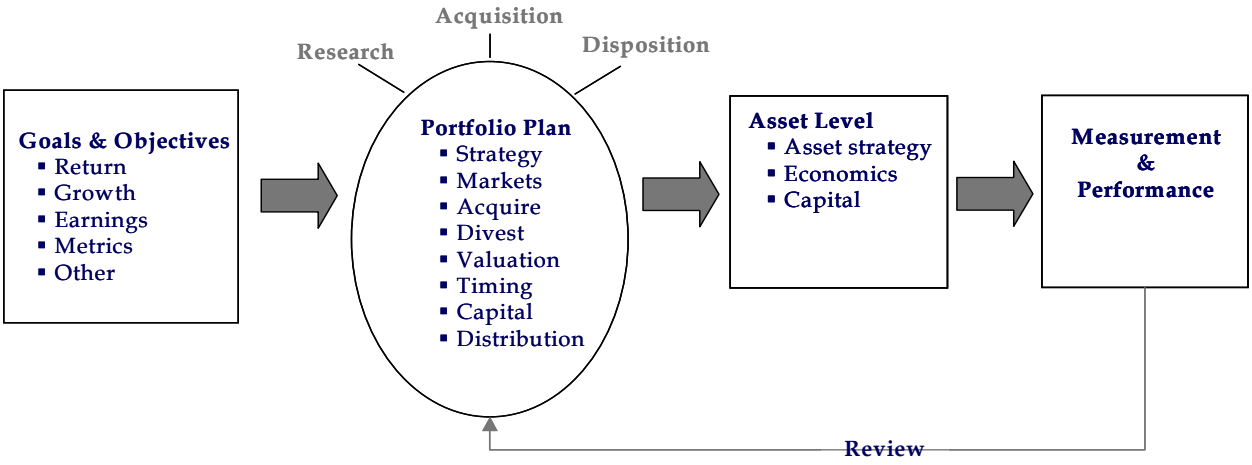
Working with these data, a plan can be formed that anticipates future needs and makes use of market value to alleviate these costs.

Surplus / investment portfolio plan

Unlike most cities, San Diego has significant real estate owned for investment purposes. The management of an investment real estate portfolio should be based on methods used by real estate investment managers and owners. Some modification is necessary to reflect San Diego's portfolio, specifically pertaining to restrictions on sale, return requirements, and the emphasis on maintaining property rather than acquiring and disposing of it.

We include both surplus property and investment property under this plan because both include property that is not required by any city department for the delivery of services, and is to be managed for maximal return to the City. The question of whether a property is to be sold or retained is partly determined by the markets for sale and lease. What is presented here is a modified version of the portfolio strategy process, derived from a survey of real estate investment trusts, real estate investment managers, and asset managers.

Portfolio Management is defined as the set of planning and operational activities used to manage a pool of real estate assets as a cohesive portfolio. Typical Portfolio Management processes include the following elements:



Five best practices

To arrive at appropriate practices in this area, we conducted a series of interviews with portfolio managers from relevant organizations. These in-depth interviews involved:

- 5 Real Estate Investment Trusts (REITs)

- 5 Real Estate Investment Managers (REIMs)
- 5 Real Estate Operating Companies (REOCs)
- 3 corporate real estate departments
- 2 investment banks

We identified five key best practices from these interviews that form the basis for our recommendations. They are:

- **Clear Portfolio Strategy** – communicated internally and externally, and based on a solid analysis of assets, markets and performance
- **Portfolio Planning** – a process distinct from portfolio strategy that makes formal recommendations on acquisitions, dispositions, entries, exits, and capital for markets and properties
- **Formal Strategy for Each Asset** – A free-standing document that guides operational decisions at the property, and that can be rolled up with others to analyze market opportunity and execution across the portfolio
- **Integration of Research** – Incorporation of market research function in asset strategy
- **Streamlined, Focused Governance** – Using tools, processes and alignment that support strategy development and execution, rather than data reconciliation and tactical decisions

The governance of these functions may be facilitated by creating the committees that support it. With modern decision support tools and communication, these committees can focus on discrete components of strategy and execution, and can manage by exception rather than by the entirety. The composition of the major committees to which portfolio management would contribute is as follows:

This process is relevant to City of San Diego, but to be applied on a smaller scale.

Committees and meetings

Active management of an investment portfolio requires committees to be formed where policy and investment strategy are set. They are as follows:

Meeting/Committee	Members	Purpose	Meeting Frequency
Portfolio Strategy Committee	Director, READ (Chair) Portfolio Managers Personnel responsible for research Additional input provided from the various Portfolio Management functions as required.	Primary forum for all portfolio strategy and management decisions relative to achieving overall portfolio performance objectives. Key sounding board for cross-market decisions and considerations.	Monthly; acts as the primary operating committee for strategic management of the portfolio.

Meeting/Committee	Members	Purpose	Meeting Frequency
Investment Committee (Considers potential new investments)	Director, READ Finance Dept. Director – Portfolio Management Head of operations Strategic Planning Personnel responsible for research	Primary forum for investment decisions from asset specific decisions to approval of organization-wide assumptions Key sounding board for strategic planning function and for budget assumptions.	As needed

Elements of a portfolio plan

This table depicts the elements found in a typical portfolio strategy. It would require adaptation by property class to be applicable to the READ investment portfolio.

OUTLINE OF A TYPICAL INVESTMENT PORTFOLIO STRATEGY	
Primary Goals	♦ Specific and usually with a financial element. Could include: ▪ Achieve an annual average yield of XX% (broken out by property type) ▪ Migrate the portfolio to a more attractive risk/reward relationship
Secondary Goals	♦ Objectives that align with and support primary financial goals, e.g. ▪ Build critical mass in certain markets ▪ Specific acquisition or disposition strategies ▪ Rationalize the current portfolio by dropping properties that do not meet a threshold ▪ Change property/portfolio financial structure – borrowing, shifting lease structures ▪ Move to formal risk/return measurement
Investment Criteria	♦ Converting goals to executable steps. For example: ▪ Acquire stable office buildings in Cities *a, b,* and *d* that can be acquired for a yield in excess of *x* ▪ Exit stabilized buildings in city *d* at a capitalization rate of *x* or better ▪ Structure shorter-term leases in market *f* to reflect upcoming market improvement ▪ Cut rental rates by *x* percent and target long-term leases in market *y*
Research Support	♦ Historical and prospective analysis that supports the conclusions detailed above ▪ Historical operating results and comparison to market ▪ Standard measures of risk and return by market (e.g. Russell - NCREIF property index) ▪ Forecast changes in market conditions – Macroeconomic View

Key elements of an asset strategy

In an investment organization, such as a REIT, a formal asset strategy is prepared for each asset. At the City of San Diego, the size of assets is much smaller, and it is appropriate to prepare asset strategies for groups of assets, with specifics as needed. Components of every strategy include:

- Market analysis
- Discounted cash flow and NPV valuations based upon anticipated holding period
- Hold / sell analysis
- Historical trend analyses – revenues, occupancy, NOI, rollover/turnover, cap ex, etc.
- Leasing strategy and plan - including leasing parameters, leasing constraints and net deal approval guidelines
- Capital plan
- Budget and variance tracking (remains updated monthly)
- Tenant credit/rollover analysis
- Environmental status and mitigation plans (if necessary)
- Capital structure analysis and constraints
- Value enhancement strategy

Type-specific elements of asset strategies

The data to be gathered for investment properties reflects the income characteristics, highest and best use, and operating history of the properties. It varies by property type, and includes both market research and property-specific information. Examples include:

Hotel ground leases

- Hotel performance
  - ADR
  - Rent as a percentage of room revenue
  - Upcoming lease events
  - Basis for ground rent (asset value, land or land and improvements)
- Market data
  - Occupancy
  - Rate
  - Additions and subtractions to supply

Office buildings

This refers to office buildings rented to third parties, including Crabtree and World Trade Center.

- Building performance
  - Occupancy, tenants size, and tenant credit
  - Rental income, net and gross

    - Operating expenses and property taxes, benchmarked against comparable properties and industry experience publications such as BOMA
    - Upcoming expirations, likelihood of renewal, and prospective restacking
- Comparison of current rents to market
- Property taxes
- Appraised value

Mission Bay Park

Property in Mission Bay Park is leased for multiple purposes, including hotels, camp sites, and recreational uses, and data appropriate for each asset type can be applied. However, legal and reporting requirements for the park also require the following:

- Percentage of land being leased for commercial use (for compliance with terms of the park)
- Identification of users – by percent of revenue and percent of area
- Appropriate economic measures by user type

Agricultural land

Almost all of the agricultural land managed by READ is held on behalf of the Water department, as both an investment and as a buffer zone to protect the watershed. In portfolio planning meetings between READ in the Water department, the following elements are necessary:

- Current lease performance
    - Lease revenue projection - showing net return to the City, and using a common basis for analysis (to reflect varying levels of service provided to different tenants)
    - Credit, timely collection
- Disposition and inventory of vacant parcels
- Role in protecting the watershed
- Operational / physical concerns
    - Types of crops and planned crops
    - Condition review – quality of maintenance
    - Risks / concerns relating to watersheds
- Market data
    - Comparison to lease rates on other properties
    - Recent land sales

Not-for-profit leases

The surplus / investment portfolio includes many properties leased to not-for-profit groups at below market. Elements of an asset strategy include the following:

- Lease analysis
    - Income
    - Expenses paid by the landlord
    - Net income or cost

- Measure of subsidy
  - The difference between market rent (or an appropriate return and market value) and actual rent, adjusted to reflect any services provided by the landlord
- Upcoming renewal dates and events
- Measures of service provided to the City
  - Attendance, people served
  - Cost per swimmer, day care, others comparable to the City – modeled by the method used by Parks and Recreation
  - Other measures of social benefit, such as provided routinely in social service agency reporting
- Status of NFP – C3, C6, charitable or otherwise
- Political district
- History of tenant demands upon the City

Public service properties

If these parcels are characterized as Active, the primary data to be maintained pertains to ongoing maintenance:

- Holding cost
- Real estate maintenance costs
- Condition

For parcels that are classified as Interim, the following are added to the list:

- Market value
- Highest and best use
- Plan for monetization
- Pricing
- Cost/Benefit Analysis

Revenue maximization strategy

All surplus / Investment portfolio properties are included in a revenue maximization strategy. Note that the strategy is not for a single parcel, but for the portfolio of properties that fit in this classification. Most of the data needed are gathered in the asset-level strategies described earlier.

- Due diligence – gathering in reviewing basic information about the property, much of which is gathered in the evaluation process.
- Market value appraisal – a more formal opinion of market value, as opposed to the preliminary estimate used in the evaluation process
- Sale/lease analysis – identification of the optimal means of monetizing the property – depending on legal ability to sell, need for capital or cash flow, property type, and required rates of return
- Disposition/leasing process – identification of the best means for marketing property, including sale to adjacent owner, request for proposal process, online marketing, auction, and others

- Consolidation into portfolio plan – treating strategies for multiple properties as a group, and identifying opportunities for market timing, bulk sales, and improved negotiations

Portfolio plan – surplus / investment properties

The call for council action includes several components:

Portfolio Review

- Broken down by property type (farmland, telecommunications tower, hotel)
- With performance data for each major property or group of properties

Upcoming Events

- Leases approaching expiration
- Leases requiring action
- Properties identified as surplus

Portfolio Response

- Market research
- Recommendation of monetization strategy (sale or lease)
- Recommended pricing

Request for action

Request for authority to execute within described terms

- Sale of surplus property
- Execution of leases within terms (authority within a box)
- Designation of properties as surplus

Disposition of properties

After the portfolio plan is approved by council, READ may dispose of properties in transactions that meet the terms approved in the plan. Negotiated transactions that fall outside of these guidelines can either be resubmitted to Council individually, or deferred for the next round of approval for this plan.

Portfolio review – all leases

All property that is or becomes available for lease under the current portfolio plan should be addressed in that plan. In particular, the portfolio plan should reflect City leasing policy and all new leases, renewals, and extensions should be regulated by that policy.

Leasing policy

Elements of a general leasing policy should include:

- **Leasing Authority –** READ should have "authority within a box" to execute leases that comply with the most recent portfolio plan.
- **Lease duration –** Council authority should be required for:
  - New leases of longer than 5 years (10 years for telecommunications leases)
  - Renewals of longer than 5 years, executed within two years of the end of the current lease in force (10 years for telecommunications leases)
  - Amendments that add more than 5 years to leases with no more than two years remaining (10 years for telecommunications leases)
- **Tenant Qualifications –** Tenants must meet requirements for:
  - Experience in the business to be conducted in the leased property
  - Financial means to perform under the terms of the lease
  - Absence of a reputation or record of dishonesty or criminal conduct
  - Good standing under its current leases for this or any other City-owned property
- **Compatible Uses -** All activity under the lease must be compatible with use restrictions on the property, including zoning, master plans, watershed protection, and others as appropriate.
- **Rents –** READ should seek market rent when leasing real property. This should reflect all aspects of market rent, including expense reimbursement and services provided by the landlord. Leases at below market rent require the approval of City Council, with the exception of those that conform to the specific requirements of the City's policy for leases to not-for-profit tenants.
- **Rent adjustments** – Lease terms up to 5 years should include periodic adjustments reflective of those found in the market, such as escalations based on the consumer price index or annual "bumps." Longer leases should provide for periodic adjustments to market levels at least every 10 years. These can take the form of periodic appraisal-based increases, with an explicit appraisal and arbitration process.
- **Appraisal assumptions –** If the periodic rental increases are tied to the appraised value of the property, then the lease should include a definition of market value, and an identification of the premise for that value. In most cases, the valuation should assume that the property is vacant and available to be put to its highest and best use, and that all required regulatory approvals to permit the current use have been obtained.
- **Maintenance responsibility –** Lease terms should require the tenant to maintain all improvements at their own expense (in single-tenant properties) or to meet specific maintenance requirements typical of market lease terms (in multi-tenant property.)
- **Leasehold improvements** – Leases shall provide the option to require the tenant to remove leasehold improvements made during the term of the lease at its expense. In the event that

improvements revert to the landlord, their value should be considered in establishing market rent for any subsequent leases, renewals, or extensions.

- **Subleases –** READ may consent to subleasing to tenants that meet the requirements of the master lease. Leases should include a provision that in the event that the sublease provides rental income to the tenant in excess of contractual rent, the lessor shall share in that excess.
- **Extensions of leases –** READ may extend leases to the extent that the extension complies with the most recent portfolio plan, and the extension is at market terms.
- **Reversionary interests** – If the City has a significant reversionary interest under an existing lease, then any extension of that lease must reflect appropriate compensation to the city for the deferral of that interest.

Not-for-profit portfolio review

Not-for-profit leases fall under the Surplus / Investment portfolio. The process for reconciling the portfolio of not-for-profit leases to reflect a revised policy should include the following steps:

For all not-for-profit tenants

1. **Gather lease data –** Review the portfolio and identify contract rents and adjustment dates. Also identify appraisal provisions and restrictions on the appraisal process.
2. **Sort the leases by adjustment date** – Identify those leases with adjustment processes either in process or due to occur in the next two years. These are the first priority.
3. **Estimate market rent –** For these leases, make a preliminary estimate of market rent.
4. **Does the tenant provide services to the City? If not proceed to Step 10**

For tenants that provide services that mitigate City responsibilities

5. **Identify services provided by tenant -** For each tenant, identify the services provided that specifically offset the City's burden, and identify the cost *to the City* of providing those services otherwise.
6. **Evaluate the appropriateness of the location** – Test to see if the services could be provided by the tenant in another, less valuable location.
7. **Negotiate the rent adjustment** – Under the terms of the adjustment provision of the lease, negotiate the rent adjustment.
8. **Report on the offset –** Report annually on the services offset, and the effective transfer of cost.
9. **Repeat –** Every year, begin the cycle again and evaluate the next wave of leases.
10. **Does the tenant provide services that support the City's goals? If no, skip to Step 17**

For tenants that support other City goals

11. **Evaluate the appropriateness of the location** – Test to see if the tenant could be served in another, less valuable location.
12. **Evaluate the tenant's ability to pay –** Identify the rent the tenant is able to pay for the space or property

13. **Estimate the subsidy requested –** The difference between market rent and the rent the tenant is willing to pay is subsidy. Measure the subsidy, and evaluate the City's willingness to provide it.
14. **Execute a lease** – if the City is willing to provide the subsidy, document the subsidy and the lease, and obtain appropriate approvals
15. **Report on the subsidy** – Report annually on the amount of such subsidy, the organizations being subsidized, and the justification for the subsidy. This should be included in the financial reporting of READ.
16. **Repeat –** Every year, begin the cycle again and evaluate the next wave of leases.

For all other not-for-profit tenants

17. **Negotiate renewal at market terms –** for tenants that meet neither criterion, there is no case for subsidy or offset. The lease should be negotiated at market terms.

Portfolio plan – not-for-profit leases

Not-for-profit leases are part of the surplus/ investment portfolio. Within the portfolio plan, the relevant components are as follows:

Portfolio Review

Summarizing several areas:

- Aggregate value of properties leased to not-for-profits
- Aggregate rent collected on those properties
- Cost of providing landlord services to tenants
- Aggregate value of City costs alleviated by tenants
- Change over the last year

Upcoming events

- Review of leases with upcoming expirations, holdovers, month-to-month tenants
- Historic rent, subsidy, and value of services for each

Portfolio response

- Proposed renewal / non-renewal action
  - Measure of proposed subsidy for each new deal
  - Summary of business case for each new deal
- Proposed re-characterization from Not-for-profit to surplus
- Revisions, if any, to the guidelines for eligibility to lease City property under subsidy

Request for action

- Adjustment of eligibility criteria as needed
- Authority to execute leases that comply with parameters

Business case development

For any department or function to make use of the City's assets, there should be a documented business case for that utilization. In practice, such cases are presented and evaluated when utilization changes, or when real estate action is called for. In this section, we discuss three areas:

- **Departmental business cases** – for expansions and contractions, or requests for new real estate
- **Ongoing business case** – for all departments, conducted as a form of continuous monitoring
- **Initial review** – procedures for establishing a base-line analysis
- **Not-for-profit business case** – For parties wanting to use City real estate at a subsidized rate

Departmental business case - For expansions, contractions and other changes

If a department or part of the department desires a change in its use of real estate, it must present a formal business case for doing so. This business case incorporates real estate analysis as well as operational analysis for the department.

Elements include:

- Required adjacencies – to related departments and functions
- Quality of space – using the rating scale described in the portfolio review, specify and justify the need for space of a given quality
- Customer proximity – location requirements driven by internal and external customers
- Special features – documentation and justification of any features not found in existing facilities (training areas, separate entrances, etc.)
- Analysis of existing portfolio – comparison of space needed to space available or soon to be available in the City portfolio. This includes space to be created or reorganized under the portfolio plan.
- Market analysis – if additional space is required, an analysis of space offerings in the market, comparing cost, quality, and alignment with space goals above.

This business case is to be submitted to a committee, ideally consisting of representatives from READ, the finance department, and the Mayor's office. Submissions are in a standard format that can be analyzed in the aggregate. They are then compared to the stacking plans and demand projections in the occupancy strategy.

Baseline business case - For departments with no change

If no changes in utilization of real estate are desired by a department, the business case process is simplified, *but not eliminated.* The fitness for purpose of real estate to departmental needs is within the analysis of utilization conducted above. So, the information provided by the department is expressed in terms of headcount, operational changes, and capacity requirements, as part of its normal ongoing reporting.

In this case, the property only appears in the detailed portion of the portfolio plan if real estate events require a decision. These could include lease expiration, departmental consolidation, or relocations of other departments and which this one depends.

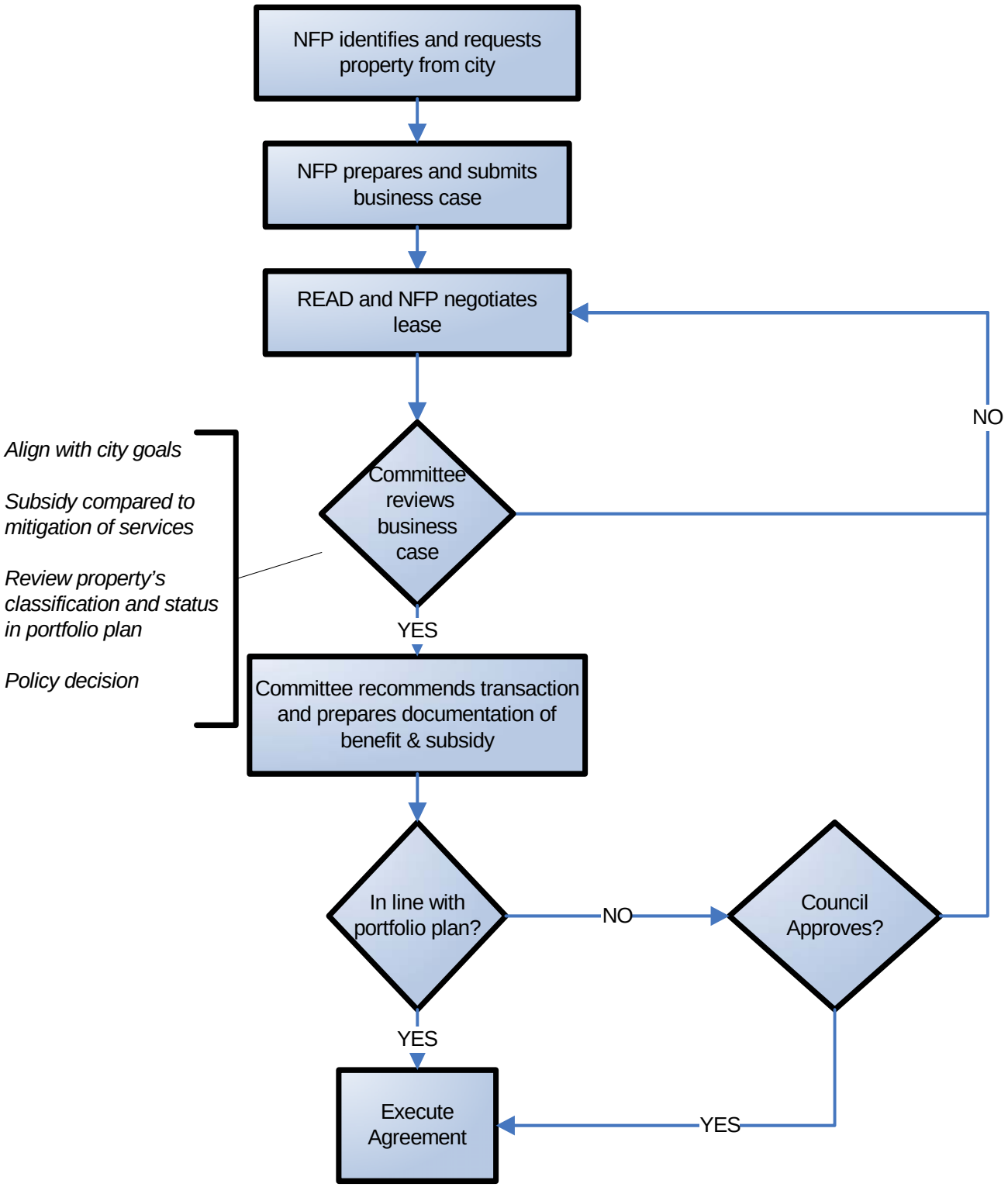
Initial review

When the first portfolio plans are prepared, it may be worthwhile to analyze departmental utilization, real estate costs, and fitness for purpose based on portfolio-level data. From this, it may be possible to identify departments that are candidates for changes in their facilities. In some corporate environments, departments are required to build the business case for their use of real estate on an annual basis.

Not-for-profit business case development

The diagram below depicts a modified version of the business case process as it applies to not-for-profit organizations. It calls for a distinct committee for reviewing not-for-profit leases, which applies criteria according to City policy. In addition, READ is called upon to measure subsidy, analyze leases, and provide history of the property.

Business case process for not-for-profit tenants



For a tenant to qualify for rent at below-market levels, policy should require the lease to meet certain criteria. The criteria and method for preparing a business case should be documented and made available to tenants. Criteria are as follows:

- **Alignment with City mission -** The selection of a nonprofit financial structure is a financial decision, and does not necessarily indicate that an organization specifically serves the needs of the City. By "Alignment with City Mission" we refer to services delivered by an organization that alleviate the City's cost or burden of providing those same services. Such services may include, among others, social services, day care, parks and recreation, recycling, and others.

  The focus here is on an organization's ability to reduce the cost of the City's delivery of those same services. To the extent that other departments publish a public service plan or other stated goals that might be offset by these tenants, that information should be incorporated in the analysis.
- **Appropriateness of the location in question –** An organization's desire to operate in a particular location does not necessarily mean that this is the highest and best use of the site. If a tenant can provide similar services to the City in a lesser location within the City's portfolio, then the current location should be put to another use.

  One response to this, adopted by other cities, is the creation of concentrations of not-for-profit uses in certain facilities. These are multitenant properties, occupied by multiple nonprofits, which can enjoy shared systems and facilities, and other efficiencies from collocation. By creating such facilities, the City may be able to house multiple nonprofits in a smaller proportion of the City's real estate.

- **Tenant activities offsetting City costs - The** primary measure of offset should be the amount by which the tenant's activities offset the City's cost in delivering services. This is not the same as the tenant's cost in delivering those services.

  For example, if the City requires day care service in a given area, and a nonprofit tenant agrees to provide those services, its rent should reflect market rent for the space, less the market cost of day care services that the City is alleviated from providing.
- **Need and subsidy -** If a nonprofit use does not alleviate the burden of the City to provide services, then any discounted rent is an outright subsidy, and should be considered under the City's policy on subsidizing nonprofit organizations, not the policy on leasing. The subsidy is defined as the difference between market rent and rent offered to the tenant at lease inception. In any decision involving such leases, the extent of the subsidy must be considered.

This should not be confused with normal divergence between market rent and contract rent discussed above. Rather, we are discussing the deliberate execution of a contract at other than market rates.

Supporting structure

For such a set of processes to function, they require an appropriate supporting structure, consisting of people, systems, authority, and monitoring tools.

People

None of this can be accomplished without an appropriately staffed and structured real estate department. The elements of such a department are as follows:

- **Management structure** – including
  - A portfolio management function, responsible for making, administering, and presenting portfolio plans
  - Asset Managers / Property Agents, responsible for acting as the owner's representative in negotiating leases and working with third-party users of City property
  - Support personnel, responsible for maintenance and administration of underlying data, timekeeping, bookkeeping, and some document production
- **Expertise**
  - Appropriate professional designations among senior personnel (CCIM, MAI, SR/WA), with distinct skill sets depending on the property type and transaction type
  - Ongoing and mandatory training programs on real estate technique, systems and procedures used in the department, and basic business skills
  - A portion of the personnel with a recent, outside experience in general commercial real estate
- **Teaming**
  - Asset Managers / Property Agents grouped by property type, and focused on a particular area of expertise (a submarket, tenant, or transaction type)
  - Each property assigned a primary and secondary responsible person to provide redundancy

Systems

The systems supporting these processes are discussed in greater detail in the *Recommendations* section of this report. In general, they are governed by the following principles:

- Central repository for documents and formats
- Database tools rather than spreadsheets for shared data
- Property management tools for leased property
- Organization-standard spreadsheets, databases and word processing tools
- Electronic document management, including hosting of scanned versions of lease and property documents
- Departmental and managerial views of portfolios, as well as data on individual properties.

These systems provide the required data to support ongoing management of the portfolio.

Ongoing operations

The adoption of such systems, as well as organization under portfolio management model, calls for day-to-day operations driven by readily accessible information and standard formats. In the following section, we describe a migration path to a "working document" methodology that combines information from multiple databases. This reflects the information requirements for ongoing maintenance of the portfolio.

Authority

Guiding principles behind the distribution of Authority for real estate decisions are as follows:

- Real estate decisions must involve real estate expertise
- Individual real estate decisions must be considered in the context of a larger portfolio strategy
- Non-real estate operational decisions that affect the demand for real estate should be informed by the portfolio strategy
- "Authority within a box" – for questions involving City Council approval, wherever possible, authority should be sought in the form of threshold levels, so that actions that need these thresholds can be executed without seeking further approval
- Management by exception – permitting the execution of actions that are consistent with approved policy, without seeking further approval
- Decisions calling for council action should be made in groups, as part of a scheduled process

The City of San Diego should concentrate its authority for real estate decisions in several ways. Suggestions include:

Authority over methodology – regardless of who has the authority to initiate or execute a real estate transaction, the means of analyzing, negotiating, and presenting such a transaction for approval should be under the control of people with real estate expertise. READ should be responsible for creating real estate performance measures, formats for presentation of approval of transactions, and support for negotiation.

Approved portfolio strategy – at present, there does not appear to be an established means by which real estate transactions are considered relative to their impact on other City real estate. This includes such areas as:

- Comparing requests for facilities to the existing portfolio of space
- Analyzing appropriateness and relative costs of different properties relative to a particular use
- Multi-year planning of facilities strategy

READ is the logical place for this authority to be concentrated. This means that any request for City facilities should be considered within the larger context of the City's overall portfolio of space. Major decisions such as adding or removing large blocks of rented space, departmental consolidations, and renovation programs cannot be made efficiently without an informed central authority guiding them.

Lease negotiations – authority for negotiating leases for any significant property should be concentrated in a real estate organization. Lease negotiation requires specialized knowledge, sources of market data, and

experience. The absence of these frequently leads to overpriced leases, inappropriately selected real estate, and larger size or longer term than is necessary.

Governance

Governance is the organizational structure and process through which organizations decide strategy and operations, and delegate and monitor execution. Governance provides the means for answering what to do, who will do it, how, when and where it will be done. It requires strong linkage and coordination of activities from READ and its customers to the field.

- **Management by exception** – formulating decision structure and processes so expected operating parameters are established and decisional focus is directed toward addressing exceptions.
- **Focus on strategy, not execution** – with management by exception, emphasis shifts from operating detail, accuracy and coordination, to strategy.
- **Clarity** – dictates what decisions are made and by whom.
- **Efficiency** – result is fewer, smaller meetings and clear delineation of decision-making responsibilities.
- **Data-driven** – effective governance requires ease of access to accurate necessary data for informed decision-making.
- **Function-driven** – attaches roles and responsibilities to functional titles, not names.

This results in better, fewer decisions – common decisions are made once, and response is clearly communicated to all involved. There is more time available for problem-solving, and decision-making and execution are understood by all involved. Strategy remains the focus and is executed in a consistent, coordinated manner. The focus of the organization changes:

From		To
Cyclic	➔	Ongoing
Reconciling detail	➔	Management by exception
Numerous meetings	➔	Key meetings and E-mail
Generalist	➔	Specialist

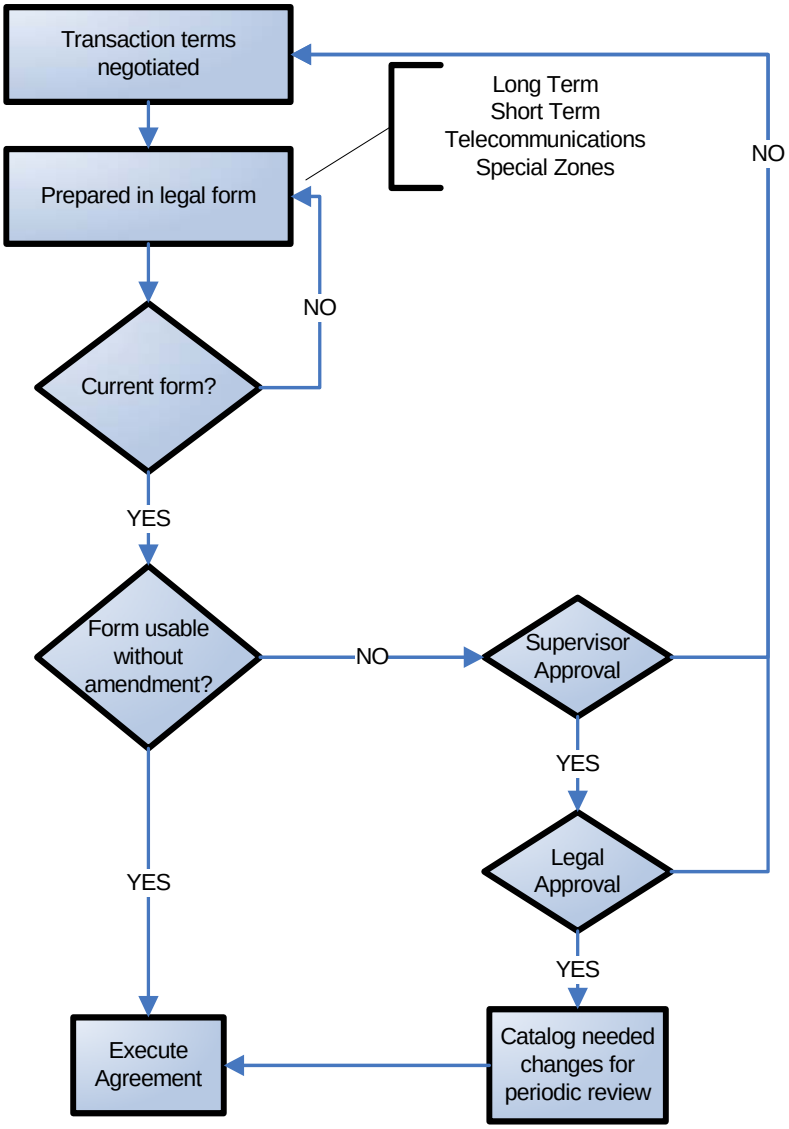
Legal document development and review

Legal documents used in transactions should start with a small standard set. This set should include:

- Long-term facility leases
- Agricultural leases – specifying terms of participation, services provided, permitted and restricted uses
- Short-term leases and agreements for facilities
- Telecommunications tower leases
- Special zones, such as Balboa Park and Mission Bay

All standard lease document forms should be available to READ, and also to potential tenants. They should be provided in downloadable form, in industry-standard formats, and marked with revision numbers and dates. At all lease renewals, effort should be made to translate leases to newer formats.

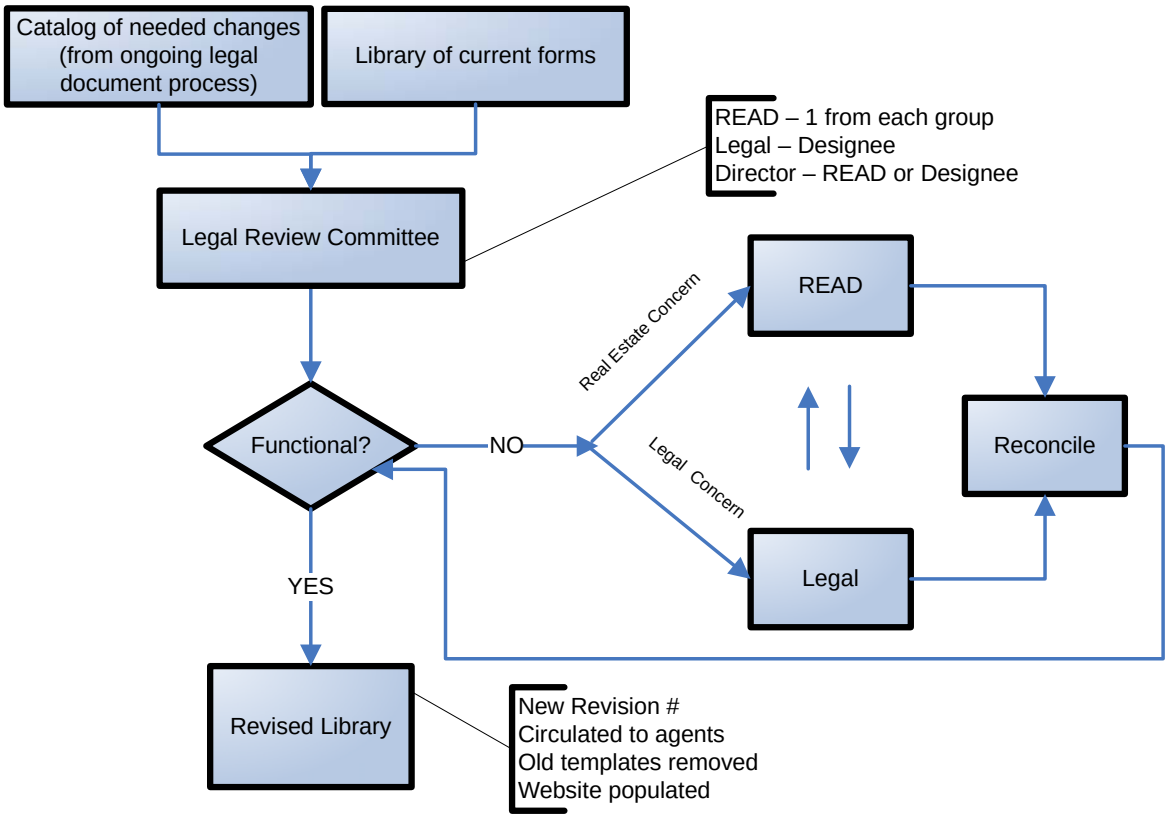
Property agents should be authorized to negotiate leases within these formats without seeking authorization on legal issues. Departures should be documented by using change tracking features in word-processing software, so that they are apparent to supervisors and to the legal department. Changes should require the approval of both the legal department and the director or designee of READ. They should also be cataloged for incorporation in future versions of these documents.



Periodic legal form review process

A legal review committee, consisting of both the Legal and READ functions, periodically reviews the library of legal documents. It is armed with both the library and a catalog of modifications that were needed in the

preceding period. It reviews the entire library, focusing on changes requested by agents, but also on consistency of format, language, and key paragraphs. The process is as follows:



Recommendations

People - recommendations

Migrating to this business model will require several changes that affect people in READ. The first of these is a renewed commitment to training.

Training

Training has been nearly nonexistent with READ, due in part to City cutbacks, and to a lack of requirements for training. This has contributed to the lack of consistent execution of processes within the department, and creates significant risk. Training is needed in several areas:

- Use of technology – basic skills in the Microsoft Office suite of products, as well as new tools adopted as the department goes forward
- New technology – The introduction of new tools and processes will require significant training as part of the process, and should incorporate an ongoing set of training materials as part of its development.
- Departmental procedures – while policies and procedures exist, many employees are apparently unaware of where to find a standard documents and past policies. Policies need to be reintroduced at a department-wide level.
- Real estate techniques – roughly half of staff in the group does not have real estate experience beyond that gathered in the course of doing its work. Many were hired as City employees, and do not bring real estate experience from elsewhere.

Sources of training

Type	Internal	Outsourced / SDDPC	Professional Education
Soft Skills ▪ Leadership/mgmt ▪ Collaboration ▪ Presentation	X	X	
General Tech ▪ Word, Excel, E-mail		X	
Industry Tech ▪ Land use, appraisal, real estate			X
Employer – specific ▪ Core Systems ▪ Processes/ org	X		

In addition, training programs can be established in conjunction with local universities. These are an excellent source of interns, assistance in developing training, and graduate volunteers for transition projects.

Creating a portfolio management function

Historically, there has been very little portfolio management taking place at READ. Portfolio decisions were either made by property agents, transaction-by-transaction basis, or during analytical exercises to support year-end reporting. More recently, some portfolio strategies have been applied, specifically in the area of downtown facilities and telecommunications leases. But for the most part, the organization has been dominated by asset management rather than portfolio management.

Creating portfolio management requires that there be people dedicated to it. The ongoing monitoring of all properties, as opposed to individual monitoring, is best accomplished by dedicated team. That team is also responsible for the consolidation of data, the assembly of portfolio plans, and the creation and monitoring of performance measures relative to portfolio performance. Portfolio managers may also be asset managers, but portfolio management is a considerable workload, and property management duties need to be lightened accordingly.

Recommendations

- Create a mandatory training program covering the topics discussed above.
- Turn to additional professional organizations for sources of real estate technical training
  - Broader array of targeted training (CCIM, BOMA, Appraisal Institute, and IRWA)
  - Compensate employees for continued professional development in approved programs – including both time and costs
- Create a dedicated portfolio management function with limited property management duties
- Retain existing groupings of property agents by property type and transaction type
- Assign two property agents per parcel, one with primary responsibility, the second as backup

Creation of a working database / working document

The adoption of technology that permits formal administration of processes can make all this possible. In this section, we discuss the migration to a "working document" environment. This refers to the creation and population of multiple databases that permit property agents to conduct their business working with summary data, in a manner that also permits portfolio management.

Goals of the database process

The working document to which we refer would be housed in several databases or in a property management system. The advantages to transferring READ data to a shared environment are as follows:

- To permit working from the abstracted data, rather than from original documents.
- To create a definitive interpretation of the real property.
- To move data into a format and an environment where it is accessible and understandable to multiple parties.
- To populate the Accounts Receivable driven elements of a lease administration tool – setting up rents and rent escalations over the life of the lease.

- To assign responsibilities, notices, and ticklers.

Approaches to data entry and quality control

Several methods can be used to populate such a system.

- **By a single team** – this assures the greatest level of consistency in abstracting, but may miss the specifics of a particular deal term. A quality control review of each property is typically performed by someone on the same team. The advantage to a team environment is that it permits the abstracting team to ask questions and overhear responses to other people's questions. It also heightens the pace of the work.
- **Broken down into tasks** – including specialized review of insurance, real property economics, and property descriptions. For this method, one centralized area should look at the final product for completeness and accuracy.
- **By person responsible for the property** – this is likely to provide the greatest understanding of individual deals, but it subjects that resulting database to inconsistencies in the work quality, level of detail, and level of skill with the abstracting tools that are found in the team of people who manage the properties. Naturally, a party that is *not* responsible for the real property (or performance of the underlying asset) should do the review as a check and balance.

Advantages of databases / property management tools

Initial data entry is either handwritten data on a data entry form or keyed in directly into a database. We recommend the latter. The reason is that a cross-database review on field by field basis can be performed. Team leaders or database specialists can review particular elements of the real property abstracts and can quickly identify and anomalies that would escape the attention of a reviewer working parcel by parcel. Examples include:

- Inappropriate responses, for example "yes" or "no" entered in a field that is supposed to contain a date
- Extra or missing digits
- Use of irrelevant fields, such as entering the number of stories for a vacant piece of land
- Cleanup of consistent errors by a single person

Using a database to administer the abstracting process offers several additional advantages:

- Field validation – using drop-down lists, formatting or other methods to ensure that a data field is correctly completed
- Simultaneous use – databases permit multiple users to work with the same record at the same time, and administer the process of making sure that modifications are reconciled.
    - Users entering multiple, nearly identical properties can use a worksheet to copy and modify them.
    - Sub-tasks can be assigned to specialists, focusing on topics such as insurance, notice dates, and responsibilities
- Separating the input and output tasks – in a spreadsheet or word processing document, the final report format dictates the environment in which one enters data. In a database, one can create

reports for any purpose, regardless of the underlying data structure. This permits much faster data entry.

Emphasis by Property Type

The working document includes different areas of emphasis, depending on the property type.

Right-of-way and non-revenue owned property

- Basic information
- Geocoding
- Location
- User information
- Responsibilities
- Notice dates

Property leased to third parties

- Lease abstract
- Lease administration info
- Geocoding information – low-grade, sufficient to plot the property on a map, but not usable for boundaries
- Accounts Receivable information
- Other information identified in the example of the working document below

Property leased from third parties

- Lease abstract
- Notice dates
- Accounts payable information
- Document management links
- Other information identified in the example of the working document below

Working document example

Attached as an appendix is an example of a working document for the READ portfolio. This is a mockup, generated in Microsoft Excel, meant to communicate the elements that should be in such a system. Prior to constructing the format shown below, we studied the abstract formats of an investment organization and a large endowment, as well as tools from Ellipsis and Grubb & Ellis Management Services. The report is color-coded, with the colors indicating the data sources for each section. The color scheme is as follows:

ABSTRACT
ACCOUNTING SYSTEM
WORKING FILES
LAND RECORDS
CRM DATABASE

- The information labeled “abstract” is critical, static real property information to be entered directly into the database as part of the formal abstracting process described earlier.

- The “accounting system” information should upload to the database report from an accounting system.
- The “working files” available electronically, are populated through links to other systems and store data that may change over the life of the agreement, such as appraisals.
- The “land records” may be stored in either working files or another database, such a tax-related database.
- The “CRM database” or customer relation management sections provide data from tools used to track interaction with other parties relating to the real property.

The working document draws from various data sources, and is intended to be run as a report for property agents. The sum of its pieces guarantees the most up to date reference tool if an event is pending or critical information is required.

Conclusions

- The “real property abstract” should be a document that combines data from a formal abstracting process, accounting information, and ongoing working files.
- Abstracts should be maintained in a database environment, rather than spreadsheets or word processing documents.
- The abstracting process should be completed by personnel familiar with the properties, but reviewed by specialists by topic.
- Scanning of real property documents should only begin if it is housed in a document management system, and supported by training
- Once scanned, paper documents must be housed offsite or in secure storage.

The creation of a day-to-day working document for each property is a significant project. This working document combines information from multiple systems, and its purpose is to permit the execution of much of a property agent's job without relying on other sources of information. The appropriate environment for these abstracts is a database, rather than a paper report. For this reason, everything in this section is discussed in terms of creating, designing, and populating a database.

Process - recommendations

The adoption of core real estate processes and related technology is a key step in addressing many of these process issues. By consolidating information and creating visibility, this adoption will create the opportunity to migrate to an effective set of processes. A key issue, however, is the elimination of old processes, which some personnel will be reluctant to give up. Areas that should get particular attention include the following:

- **"Rogue databases”**– databases created independently, in spreadsheet environments, to permit personnel to work outside existing systems. These typically evolve when systems are inadequate, but they sometimes persist after transition, and can make the transition slower and less effective.

- **Legacy software** – systems, templates, conversions, and methods developed in older software, such as Paradox, WordPerfect, and others, are often very hard to give up. A two-pronged approach, consisting of the removal of old software, and assistance in converting old tools, can assist in making this transition.
- **Training** – focused on new procedures, performance measures, and accountability. By simultaneously providing knowledge on how to work in the new environment, and information on how it directs personal success, an organization can accelerate the transition.
- **Forms** – Training in new systems, and in word processing and Acrobat, can help users create forms that reduce work, rather than creating it.
- **Electronic cleanup days** – institutional knowledge is often concentrated on personal network spaces and local hard drives. A person-by-person exercise in removing and relocating these files, combined with training in how to store them in the new file structure, can identify the vital information and reduce risk. It is also an excellent opportunity to identify rogue databases and Legacy software (see above.)

Document management - recommendations

Successful scanning of documents only occurs if the original paper documents are made physically unavailable (e.g., an off-site location) once they are scanned. READ's documents are already structured and indexed according to a rigorous system. So, if a user were to walk to the shelf that once contained a paper document, and instead be greeted by a notice that these documents have been scanned and are available online, the navigation of that online system should become nearly instinctive. If, instead, the paper documents remain available, users will continue to maintain these files, and their electronic counterparts will quickly become inconsistent and therefore useless.

Tools

The handling of the digital versions of paper documents is not a new technology. We are aware of two products already in use by the City of San Diego that include the necessary core capabilities. These capabilities include hosting of electronic files, support of OCR (optical character recognition) and indexing of files. The two products are as follows:

- **Documentum** – a comprehensive document management system that includes routing, approvals, and other workflow features. This is a relatively expensive system, with significant incremental cost to add licenses.
- **XDOC by Axacore**– a simpler system that can support hosting of files and other basic document handling features, and permits .NET integration with e-mail and other applications. There is no incremental cost (according to the City) to adding licenses for READ.

Scanning policy

A clear policy on document retention and scanning is also needed. Best practices indicate the following:

- All executed legal documents relating to property

    - Scanned and indexed
    - Physically removed and stored offsite in secure storage
- Working scanned files to include
    - Legal documents
    - Descriptive documents
    - Correspondence relating to the property
- Do not scan or retain
    - Drafts of agreements or letters
    - Interim versions
- Process for updating paper files
    - Relies on document management system for indexing and cross-referencing
    - Does not add new documents to existing files, but stores them as new records

Electronic document retention policy

Electronic files will be an increasing part of the process of managing properties. A policy regarding the spreadsheets, word processing documents and other files should include

- Final versions of all materials used in managing property
    - In write-protected form
    - Stored in a central repository that is backed up
- Do not scan or retain
    - Interim versions or incomplete work

Real estate-specific technology - recommendation

Because of the environment in which they are written, their age, and the lack of documentation, CORP and LIBS are not worth upgrading. Any solution going forward should translate the data, map it into the new systems, create a bridge to the Accounts Payable systems, and accounts receivable systems, and migrate to modern system. The question remains as to which system.

We are asked to provide an analysis and review the leading ERP solutions as a viable solution for the management of real property operations and inventory. The use of ERPs for real estate is not the approach taken by most real estate organizations, and is not the appropriate approach here. The reasons are as follows:

- The City's portfolio is too diverse and not large enough to justify the effort required to create an appropriate system.
- Existing ERP real estate solutions focus on facilities management, large portfolios of similar office or industrial space, and real estate investment trusts. This does not align with the City's portfolio.

- "Best-in-class" solutions, composed of multiple non –ERP components, are available to meet the City's real estate management needs.

The tools required for READ can be broken down into the following categories: lease administration and accounting, customer relationship management, document management, asset database, GIS, and basic Office applications. In our experience, the best solutions include a combination of databases, lease administration programs, electronic document management, and standard office tools.

Why not an ERP?

Enterprise Resource Planning systems (ERPs) integrate (or attempt to integrate) all data and processes of an organization into a single unified system. A typical ERP system will use multiple components of computer software and hardware to achieve the integration. A key ingredient of most ERP systems is the use of a single, unified database to store data for the various system modules.

- Major benefits:
  - Improved coordination across the functional departments
  - Increased efficiencies
- Add-ons include
  - CRM (customer relationship management)
  - SCM (supply chain management)

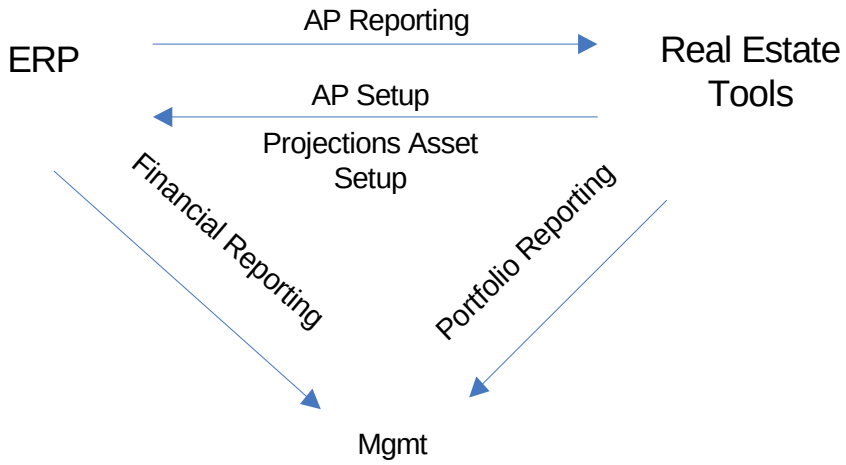
The problem lies in the absence of customized modules that are well-suited to the City's portfolio and processes. Other than governments, very few organizations have portfolios that include the diversity of property held by the City. Existing ERP real estate modules are typically strong in tracking owned or leased assets of manufacturing companies, in which the assets are large and held for a long time. The effort required for a day-to-day monitoring and administration of the mostly small assets at the City in any ERP would prove unacceptable.

In the course of our peer research, we identified no municipalities that were satisfied with an ERP-native real estate solution. Instead, we found a mixture of spreadsheets and databases, and the occasional adoption of dedicated lease administration and property management tools with bridges to ERP systems. This parallels our experience in the investment and corporate real estate world, in which most organizations worked with proprietary or dedicated real estate tools.

Flow of information

From an accounting perspective, almost all of the information flow regarding real estate is outbound from READ. This includes lease information, valuations, set up of receivables, and projections of future income and expense. The only information flowing in the other direction consists of collections data – dates and amounts of payment. (This is not the case at present at the City, but it does reflect the nature of information flow in a typical organization.) Because of this, there is little benefit to requiring a real estate department to base its selection of tools on the ERP selection for a much larger organization.

The ideal solution is one in which the strategy and administration of real estate is accomplished using real estate-specific tools, which exchange information with enterprise accounting systems at a summary level. Other than data on billing and collections, inquiries on property information are handled without involving the enterprise-wide system.



ERP accounting

All of the major ERPs include capabilities for integration. The primary criterion for selection should be (as it relates to real estate) the ease with which inbound and outbound data transfer can be made. An appropriate goal is for nightly transfer of receivables and collections information.

Property administration

Property administration tools are dedicated systems that maintain lease abstracts, histories of conversations, expense information, and asset records. They are typically provided in Application Service Provider form, or ASP, which permits access via Web browsers on typical desktop computers. The level of integration with accounting systems varies, from none whatsoever to customized links that populate and monitor accounts receivable systems.

These systems include hosting of lease abstract information, maintenance of ticklers and notice dates, links to digital versions of lease documents, and creation and maintenance of accounts receivable and payable information. Leading applications include:

- Virtual Premise
- Harbor Flex
- AMTdirect
- Manage Path
- ProLease
- Ellipsis

CAFM tools

A Gartner study conducted in 2004 identified several tools as being viable solutions in the corporate real estate realm. This raises the question of why they are not appropriate here. The Gartner work focused primarily on CAFM (Computer-aided facilities management) solutions such as Archibus and Workplace IQ. These systems address the majority of their efforts an area that is not now among the duties of READ, namely the management of office space and facilities in terms of seat assignments, construction project management and cost allocation. While they incorporate varying degrees of functionality relating to asset management, it is not their core strength. Further, the applications work best in the large portfolios of relatively homogenous real estate, where the extensive customization required is worth the effort.

The portfolio at the City of San Diego includes an extraordinarily diverse mix of property types, space sizes, and real estate challenges. Although the portfolio is large, the permutations necessary in a customization of a real estate application would make it impractical. These tools are also not appropriate for management of the City's portfolio of assets leased to third parties. Their focus is on facilities planning and utilization.

However, READ could benefit from CAFM tools if they are adopted in other City departments. These tools relate to the day-to-day management of buildings – move/add/change orders, preventive maintenance, and work orders. However, the best of them also include portfolio planning features that provide data on occupancy, costs, and departmental utilization of real estate. This is of particular interest in the City's management of office real estate. Any selection of a CAFM should include these features. Leading applications include:

- ARCHIBUS
- FAMIS
- TRIRIGA
- Bricsnet
- Business Integration Group (BIG)
- WorkplaceIQ

GIS

Geographic information systems provide a vital method of indexing in identifying real estate. They also permit reconciliation of geographic data without matching addresses or property numbers. However, by far the largest benefit of GIS is found in the area of public works. Best, any solution selected for the Real Estate Assets Department will be driven by concerns of public works departments, including Water and Parks.

Conclusion

Most corporate and government real estate organizations elect to create real estate systems based on a best-in-class model. They select real estate-specific tools, and integrate them with core accounting systems that are selected outside of the department. The nature of READ’s portfolio makes this a particularly appropriate recommendation here.

Functional requirements for technology solution

Any technology solution selected should meet the following functional requirements:

- General requirements
  - Graphical User Interface (GUI)
  - Compatible with contents of Legacy database
- Lease information
  - Lease setup including all fixed rent increases
  - Billing/Invoicing for leases
  - Payment status
  - Two-way information flow with citywide accounting system with daily updating
  - Ability to prevent depositing of rent from tenants that are in process of being evicted

Operational support

  - Storage or indexing of letters and memos from property agents to supplement lease/property files
  - Links to scanned documents
  - Record of communications regarding leases
- Ticklers and reminders
  - For property events
  - For lease events
  - For nonpayment / late payment
  - In a consolidated screen or report, with the ability to prioritize or mark as complete
- Management tools
  - Ability to balance and have insight into property agent workload.
  - Ability to evaluate risk of the lease portfolio by being able to select a range of leases for evaluation based upon elements within the lease.
  - Workload analysis reports for managers
- Standard lease agreements that speed processing with the City Attorney and simplify agent work.
- External links
  - Ability to refer to and link to electronic document management systems
  - Ability to store geocoding for each parcel
  - Ability to link *into* the system from future GIS applications

External communication - recommendations

Successful communications plans can reduce workload, and improve both real and perceived performance by the department. Much of the work of READ is repetitive communication, and needs to be both consistent and efficient. Actively addressing this communication includes the following:

- Add frequently-requested information to the READ portion of the City's web site
  - Listings of available and surplus property
  - Legal forms for leases, crossings, easements
  - Detailed contacts by property type
  - Links to other sources in the City for related questions
- Financial analysis
  - Revenue Projections
  - Hold / sell analysis
  - Net present value (NPV) analysis
- Publish a "state of the portfolio" report on an annual basis
  - Based on information from the portfolio plan
  - Available online and in printed form
- Create status reporting on ongoing issues
  - Supported by new technology, so that more than one person can answer questions about a portfolio
  - Proactive – with information sent out on key transactions
  - Possibly available through a web site
- Station a person or persons at the front door to the department
  - Either a dedicated receptionist with other functions, or
  - Relocating other functions to this area (a modification of current procedure)

Performance measures - recommendations

Appropriate performance measures for READ break down into three groups:

Real estate measures – First is the creation and addition of standard real estate performance measures, including calculation of rates of return, occupancy, space quality, and comparison to market. The data to create many of these already exists in READ, but not in a format that permits portfolio analysis. The implementation of new real estate technology will create an opportunity to provide this kind of performance measure. Specifics of these measures are found in the discussion of the portfolio plan, on page 40.

- For Surplus / Investment portfolio
  - Investment performance
  - Occupancy
  - Spread between actual and market rent
  - Leases in holdover
  - Average remaining term on leases
  - Property value and change in value
  - Delinquency rate

- For Public Service Portfolio
  - Changes in portfolio
  - Quality assessment of properties, and change in same
- For Corporate portfolio
  - Occupancy cost
  - Occupancy
  - Spread between actual and market rent

Execution-driven measures – Second is the set of measures relating to execution, including response times, unresolved transactions, histories of negotiation, and accuracy and completeness of property records. Awareness of these measures, as well as their transparency across the organization, is a powerful motivational tool. These measures would be made available both to the personnel responsible for portfolio and to the portfolio management team.

- Reports by group and by agent
  - Service requests handled per month
  - Response time
  - Quality of information (as rated by customer surveys)
  - Ability to answer questions
  - Customer satisfaction (through follow-up surveys)
  - Portion of portfolio visited in last reporting period
- Cost of service per acquisition (average, and as percentage of total cost)
- Adherence to budget

Transitional measures – This set consists of measures related to managing the transition to a new business model. These measures would be created simultaneous with the development of a transition plan. This includes:

- Adherence to schedules
- Adherence to budgets
- Implementation planning
- Successful transitions

Service level agreements (SLAs) – The existing SLAs between READ and both the Water and Wastewater Departments should be modified to incorporate elements from both the portfolio planning process and the execution-driven measures above. These measures should include:

- SLA compliance
- Percentage of work covered by SLAs
- Meeting customer service expectations

Authority and governance - recommendations

Multiple City departments make independent real estate decisions. This has negative effects on the City, including:

- Long-term leases for space that houses short-term needs
- Inefficiencies arising from the lack of an overall view of space use
- Leases for similar properties at different rates
- Space obtained without adequate parking
- Inappropriate selections of space for functions
- Unclear information presented to City Council for approvals

These concerns mirror those that are found in organizations without a mature real estate function. They reflect real estate decisions made without the benefit of real estate expertise, and without the benefit of portfolio strategy.

For READ to achieve superior performance of its real estate, it requires improved use of authority. Specifically, it should operate under the following principles:

- Batched approval – most real estate decisions requiring Council action should be approved as part of a portfolio plan, rather than as individual transactions. The creation of an annual planning process permits both READ and Council to devote appropriate attention to these decisions.
- Authority within a box – once a portfolio plan is approved, including thresholds and terms for typical transactions, READ should be free to execute those transactions that comply with these guidelines. The appropriate focus of Council is to periodically review the guidelines and to address exceptions.
- Management by exception – in a modern portfolio management environment, the focus should be on anomalous transactions, and on the monitoring of a flow of routine transactions.

Many of these concerns are addressed in the adoption of the real estate processes described earlier. The conferring of authority becomes inherent in the approval process, and real estate decisions that were being made outside of READ are replaced by participation in committees that include stakeholder departments and READ. By evaluating portfolio plans, rather than individual real estate decisions, the net result should be superior decisions, defensible positions, and considerably fewer meetings with less wasted time.

Conclusion

The City of San Diego has an opportunity to adopt a portfolio management model and to rebuild its operations in support of that model. In doing so, it would improve customer service, increase financial return from its assets, and position itself to provide superior facilities to City operations. Doing so would require significant investment of time and money. READ has a competent and dedicated staff which requires proper training, appropriate tools, and transition support to accomplish this transformation to the proposed new model. It would also require significant support from customer organizations and from the City administration.

In adopting this model, READ would become a leader among municipal real estate organizations. It would demonstrate the applicability of processes that are well-proven in the corporate and the investment real estate environment, but that have not yet been widely adopted in municipal real estate. There is no existing template that can be applied directly to the department. However, the components exist, and the possibility is there.

It may appear that READ can wait for somebody else to invent the appropriate approach. Trends in government real estate management, developed in the United Kingdom, are gaining acceptance in the United States. Other municipalities have begun to explore similar issues, and the Office of Management and Budget has already mandated similar measures for certain federal agencies. This does not mean that a ready-to-use template will emerge for later READ migration. The City of San Diego has an unusual real estate portfolio, because of its Pueblo lands and because of its financial constraints. The portfolio management model as applied in San Diego will require tools and approaches that are unlikely to be invented elsewhere. There is no reason to wait.

Summary of recommendations

Mission

READ should modify its mission statement to include the following:

"The mission of READ has three major components:

- *Acquire and manage real estate required for government functions and services*
- *Generate revenue through leasing and sales of surplus assets, and*
- *Maximize the overall financial return on the City's real estate portfolio"*

Processes

READ should review the City's portfolio of property, and categorize properties

- by function (Corporate, Public Service, and Surplus / Investment)
- and by status (Active, Interim, Surplus / Investment)

READ should adopt a formal, annual portfolio planning process, incorporating the following:

- A review of the portfolio
- An operating plan for corporate property
- An investment or disposal plan for surplus property
- Market research and specific parameters for anticipated transactions in support of these two plans
- Request for authority to act within those parameters without any further City Council action

READ should work with other departments to prepare an overall facility strategy that considers

- Quality and interchangeability of space
- Departmental use and plans for change
- Market data and lease economics

People

The structure of READ should be modified to create

- A portfolio management function, responsible for making, administering, and presenting portfolio plans
  - Asset managers, responsible for acting as the owner's representative in negotiating leases and working with third-party users of City property
  - Support personnel, responsible for maintenance and administration of underlying data, timekeeping, bookkeeping, and some document production
- **Expertise**
  - Appropriate professional designations among senior personnel (CCIM, MAI, SR/WA), with distinct skill sets depending on the property type and transaction type

    - Ongoing and mandatory training programs on real estate technique, systems and procedures used in the department, and basic business skills
    - Hire a portion of new personnel with recent, outside experience in general commercial real estate
- **Teaming**
    - Asset managers grouped by property type, and focused on a particular area of expertise (a submarket, tenant, or transaction type)
    - Each property assigned a primary and secondary responsible person

Performance measures

Necessary monitoring of READ's activities breaks down into three components.

- **Real Estate measures**: rates of return, occupancy, space quality, and comparison to market.
- **Execution-driven measures**: response times, unresolved transactions, histories of negotiation, and accuracy and completeness of property records.
- **Transitional measures**: adherence to schedules, implementation planning, and successful transitions.

The existing Service level agreements (SLAs) between READ and both the Water and Wastewater Departments should be modified to incorporate elements from both the portfolio planning process and the execution-driven measures above.

Technology

READ requires a modern system that supports

- Portfolio monitoring
- Performance measures
- Project tracking
- Information necessary for property agents to accomplish their work.

Technology going forward should

- not upgrade CORP and LIBS
- Translate the data
- Map it into the new systems
- Create a bridge to the accounts payable and accounts receivable systems
- Migrate to modern system.

This system will allow READ to have:

- Central repository for documents and formats by scanning documents and storing originals off-site.
- Database tools or shared environment rather than spreadsheets for shared data
- Organization-standard spreadsheets, databases and word processing tools
- Electronic document management, including hosting of scanned versions of lease and property documents
- Departmental views of portfolios, as well as data on individual properties.

Authority

For READ to achieve superior performance of its real estate, it requires improved authority:

- Batched approval - Presentation of groups of properties or entire strategies for City Council approval
- Authority within a box – Pre-approval of transactions that meet defined standards
- Management by exception – Approvals should be required only for departures from standards

The City of San Diego should concentrate its authority for real estate decisions in several ways. Suggestions include:

- **Authority over methodology** -- The Real Estate Assets Department should be responsible for creating real estate performance measures, formats for presentation of approval of transactions, and support for negotiation.
- **Approved portfolio strategy** –
  - Comparing requests for space to the existing portfolio
  - Analyzing appropriateness and costs of different properties relative to a given use
  - Multi-year planning of space strategy
- **Lease negotiations** -- authority for negotiating leases for any significant property should be located in READ.

Governance

Governance requires strong linkage and coordination of activities from READ and its customers to the field.

- **Management by exception** – formulating decision structure and processes so expected operating parameters are established and decisional focus is directed toward addressing exceptions.
- **Focus on strategy, not execution** – with management by exception, emphasis shifts from operating detail, accuracy and coordination, to strategy.
- **Clarity** -- dictates what decisions are made and by whom.
- **Efficiency** – result is fewer, smaller meetings and clear delineation of decision-making responsibilities.
- **Data-driven** – effective governance requires ease of access to accurate necessary data for informed decision-making.
- **Function-driven** – attaches roles and responsibilities to functional titles, not names.

Communication

Actively addressing external communication includes:

- Adding frequently-requested information to the READ portion of the City's web site
- Publishing a "state of the portfolio" report on an annual basis
- Creating status reporting on ongoing issues
- Stationing a person or persons at the front door to the department

Effective internal communication requires the following:

- Consistent File structure
- Consistent and updated document formats
- Definitive library of legal forms

Appendices

Interview process

We interviewed READ personnel, City departments, and San Diego area organizations. Our interviews focused on individual background, general responsibilities, organizational process, technology tools, and questions/comments from interviewees. We also collected and analyzed demographic data and key performance measures.

Real Estate Assets Department (Interviewees) – City of San Diego

Mathew Alger	Information Systems Analyst
Jim Anthony, RPA, SR/WA	Supervising Property Agent, Asset Management
Jim Barwick, CCIM	Director
Diane Bartko	Supervising Property Agent, Corporate Services
Cathy Chavez	Lease Billing Supervisor
Paul Crawford	Property Agent, Asset Management
Steve Geitz, SR/WA	Supervising Property Agent, Acquisition & Asset Management
Gary Jones, SR/WA	Supervising Property Agent, Asset Management
Lane Mackenzie, SR/WA	Supervising Property Agent, Acquisition Group
Dave Martens	Property Agent, Agricultural Leases
Peggy Martinez	Senior Management Analyst
David Sandoval, CCIM	Deputy Director
Sue Taylor	GIS/Records Manager
Carol Young	Property Agent, Telecommunications Site Marketing

Other Interviewees

Dave Allsbrook	Manager–Contracting/Public Works, Center City Development Corporation (CCDC)
Tom Fleming	President / CEO, San Diego Data Processing Corporation
Kent Floro	Deputy Director, Water Department, City of San Diego
Robert Kennedy	Project Manager, Redevelopment Agency, City of San Diego
Brock Ladewig	Chief Deputy City Attorney, City Attorney's Office
Jim Myer	IT Group Manager, Land Use & Economic Development, City
Rick Reynolds	Assistant Chief Operating Officer, City of San Diego
Shaun Sumner	Assistant Asset Manager, Port of San Diego

Peers

We interviewed 9 cities and 7 companies. We focused on several areas including approval processes, technology, personnel, portfolio review, and asset/project management.

- Municipalities
  - Austin
  - Dallas
  - El Paso
  - Houston
  - Indianapolis
  - Las Vegas
  - San Diego
  - San Jose
  - Seattle

- Public/Private Institutions
  - Commercial Office Properties Trust
  - Kamehameha Schools / Bishop Estate
  - Shell Oil
  - The Irvine Company
  - Union Pacific Railroad
  - LaSalle National Bank
  - Commercial Net Lease Realty

Data Sources

In this course of our work we relied on the following documents and data sources:

Name	Description	Source
READ FY2006 Proposed Budget	READ Fiscal year 2006 Budget	City of San Diego (READ)
CORP DATA EXPORT 090506	City owned/managed property	City of San Diego (READ)
LIBS DATA EXPORT 090106	City as Lessee or Lessor property	City of San Diego (READ)
LIBS CORP Codes	LIBS Data Definitions	City of San Diego (READ)
Agreement Summary Report	# of Sites/Acreage by Agreement type	City of San Diego (READ)
Municipal Government Peer Review	GBE Municipality Survey	Grubb & Ellis Company
Non-governmental Peer Review	GBE Corporate Peer Survey	Grubb & Ellis Company
Real Estate Software Solutions	GBE RE Software Solutions Survey	Grubb & Ellis Company
Municipal Quantitative Statistics	Municipal Demographic Survey	Grubb & Ellis Company
Survey of other City Non-Profit Leases	Non-profit leasing policy in other cities	City of San Diego (READ)
Nationwide Real Prop Mgt Systems	Matrix of RE Asset/Portfolio Mgmt Sys	City of San Diego (READ)

Grubb&Ellis®
Property Solutions Worldwide

Run Date:

TYPE OF AGREEMENT:	ASSET TYPE:	CITY IS ___ LESSOR ___ LESSEE
PROPERTY NAME:	PROP/LEASE ID: (Link to PDF doc)	Asset Manager:

LAND & IMPROVEMENTS INFORMATION

PARCEL NO(S) _____
PARCEL NO(S) _____
PLANNING DISTRICT

COMMENTS ON IMPROVEMENTS: _____

TENANT INFORMATION:

LEGAL NAME/OWNER: _____
BILLING NAME: _____ OCCUPANT DBA: _____
BILLING ADDRESS: _____ OCCUPANT ADDRESS: _____
ATTENTION: _____ CONTACT NAME: _____
PHONE #: ( ) - PHONE #: ( ) -

SUITE INFORMATION:

SUITE/UNIT #: _____ FLOOR #: _____
SQ. FEET: _____ (GLA) (MLA) PRORATA SHARE: _____
DESCRIPTION / USE: OTHER: _____

LEASE INFORMATION:

(MODIFIED) (NET) (GROSS)

TYPE: _____ TERM: _____
EXECUTION DATE: _____ LEASE COMM DATE: _____
OCCUPANCY DATE: _____ LEASE EXPIR. DATE: _____
RENT COMM DATE: _____ VACATE DATE: _____

DEPOSIT:				**PREPAID RENT:**			
AMOUNT:		FROM:		AMOUNT:		FROM:	
PAID TO:		DATE PAID:		PAID TO:		DATE PAID:	
TERMS:				TERMS:			

RENT:

BASE RENT: FROM: TO: AMT/MO: $/SF:
FROM: TO: AMT/MO: $/SF:
HOLDOVER FROM: TO: AMT/MO: $/SF:

DUE DATE: _____ DELINQUENCY POLICY: _____
LATE FEE POLICY: FLAT: RATE: SALES TAX: _____ RENT STMT (Y/N):
LATE FEE: _____ OTHER: _____
ADJ. TYPE/CALC. METHOD: _____
COMMENTS/HISTORY: _____

PERCENTAGE RENT:

PERCENT RENT:	REPORTED (M/Q/S/A):	PAID (M/Q/S/A):		ADJUSTED (M/Q/S/A):	
PERCENT RENT:		BREAKPOINT:		EFFECTIVE DATE:	
PERCENT RENT:		BREAKPOINT:		EFFECTIVE DATE:	
COMMENTS:					

PARKING/STORAGE:

PARKING/BILL CODE:		# OF FREE STALLS		# OF PAID STALLS		MONTHLY RATE	
STORAGE/BILL CODE:		UNIT #		SQUARE FEET		MONTHLY RATE	

ADDITIONAL INFO:

ALLOWANCES/CONCESSIONS:

FREE RENT: FROM: TO: AMT/MO:

FROM: TO: AMT/MO:

FROM: TO: AMT/MO:

NOTES:

OPTIONS:		DATE OF NOTICE
RENEWAL:		
EXPANSION:		
1ST OFFER/REFUSAL:		
TERMINATION:		
OTHER:		

CPI ADJUSTMENTS:

CPI TABLE: ANNUAL/PRO BILLING:

BASE MO/YR: COMP. MO/YR:

FREQUENCY: FIRST EFF DATE:

MAX/MIN INCREASE: LIFE CAP:

FORMULA:

COMMENTS:

OPERATING EXPENSE PARTICIPATION:

RECOVERIES (ESCALATIONS OR CAM):

PRORATA SHARE: EST. AMT/MO:

BASE YEAR: BASE YR EXP:

EXPENSE STOP: EXPENSE CEILING:

EXCLUSIONS:

FORMULA:

COMMENTS:

R. E. TAXES:

PRORATA SHARE: EST. AMT/MO:

BASE YEAR: BASE YR AMOUNT:

FORMULA:

COMMENTS:

INSURANCE:

PRORATA SHARE: _____ EST. AMT/MO: _____

BASE YEAR: _____ BASE YR AMOUNT: _____

FORMULA: _____

COMMENTS: _____

ELECTRICITY:

PRORATA SHARE: _____ EST. AMT/MO: _____

FORMULA: _____ COMMENTS: _____

WATER:

PRORATA SHARE: _____ EST. AMT/MO: _____

FORMULA: COMMENTS:

GAS:

PRORATA SHARE: _____ EST. AMT/MO: _____

STORAGE/BILL CODE: _____ COMMENTS: _____

OTHER DIRECT PASS-THRU'S: MERCHANT'S

MGMT/ADMIN FEE: _____ ASSOC. DUES: _____

COMMENTS: _____

INSURANCE INFO:

INS CERTIFICATE:	ON FILE (Y/N):		CARRIER:		LIMITS	
OTHER:					OWNER INSURED (Y/N):	
					G&E ADD'L INSURED (Y/N):	

Uses:

Sub-agreements:

Predecessor Agreements:

APPRAISALS

APPRAISER:	ESTIMATED RENTS:
DATE OF VALUE:	ESTIMATED VALUES:
RATE OF RETURN:	
APPRAISER:	ESTIMATED RENTS:
DATE OF VALUE:	ESTIMATED VALUES:
RATE OF RETURN:	
COMMENTS:	

NOTIFICATIONS

TASK TYPE	RESPONSIBILITY NAME	TITLE	PLANNED START	PLANNED FINISH	COMPLETION DATE

APPROVALS:

(1) ABSTRACTED BY: _____ R. E. MANAGER OR BLDG MGR DATE

(3) POSTED/SYSTEM: _____ ACCOUNTING DATE

(2) APPROVED BY: _____ REGIONAL MANAGER DATE

(4) PROFILE APPR'D: _____ R.E. MANAGER OR BLDG MGR DATE

COLOR CODING LEGEND: REPORT CODED BY DATA SOURCE

ABSTRACT
ACCOUNTING SYSTEM
WORKING FILES
LAND RECORDS
CRM DATABASE