

September 1995

Asset Management Strategies  
for the Los Angeles County  
Real Estate Portfolio

A Study by

The Los Angeles County  
Citizen's Economy and Efficiency Commission □

September 19, 1995

Honorable Gloria Molina, Chair  
Los Angeles County Board of Supervisors  
Room 856, Hahn Hall of Administration  
500 West Temple Street  
Los Angeles, CA 90012

Dear Chairperson Molina:

The attached report entitled, Asset Management Strategies for the Los Angeles County Real Estate Portfolio, presents strategies for the County's Asset Management Program.

On June 15, 1995 the Board of Supervisors requested that the Economy and Efficiency Commission review the Chief Administrative Officer's report of April 20, 1995 on the Revenue Potential of County-Owned Real Property Assets. We formed a team comprised of the Economy and Efficiency staff, Ms. Patricia Flynn, of Coopers & Lybrand, and Mr. John Salmon, former Director of the Governor's Office of Asset Management. This team worked with County staff from the Chief Administrative Office (CAO), the Internal Services Department (ISD), and County Counsel to review information concerning the County's assets and organizational structure. The results of this review are reflected in the report's 26 recommendations. Implementation of these recommendations has the potential for estimated annual savings of over \$27 million. In addition, there is the potential for estimated one-time savings of \$20 million.

We look forward to assisting you in reviewing the implementation of the recommendations.

Sincerely,

Gunther Buerk  
Chairperson

C: Each Supervisor  
Each Economy and Efficiency Commissioner  
Sally Reed, Chief Administrative Officer  
DeWitt Clinton, County Counsel  
Alan Sasaki, Auditor-Controller  
Larry Monteilh, Treasurer/Tax Collector

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ASSET MANAGEMENT STRATEGIES  
FOR THE LOS ANGELES COUNTY  
REAL ESTATE PORTFOLIO

I. EXECUTIVE SUMMARY

On June 14, 1995, the Board of Supervisors requested that the Economy and Efficiency Commission review the Chief Administrative Officer's ("CAO") June 12, 1995 report to the Board. In this report the CAO stated that 99.8% of County-owned real property is so restricted that immediate revenue potential from the disposition of such assets is limited. (Attached as Appendix A)

KEY FINDINGS, CONCLUSIONS AND RECOMMENDATIONS:

1. CAO's June 12, 1995 report; correct but misleading. The CAO's report was correct in that immediate revenue potential from disposition of real estate assets is limited and will be of little help in resolving the current budget crisis. However, the CAO's conclusion that 99.8% of real estate assets cannot be better utilized was determined by land area, including parks. As such, the report was misleading and did not meaningfully assess revenue potential or potential savings from more efficient use of properties.
2. Significant long-term savings are possible. Immediate implementation of recommended asset management strategies would create the potential for one-time savings of approximately \$20 million and sustainable annual savings of approximately \$27 million. Two examples:

Savings from consolidation. The County's real estate inventory includes a number of owned and/or leased office facilities within close proximity to other office facilities with compatible use requirements. For example, the County owns approximately 211,000 square feet of office space on Vermont Avenue and 47,000 square feet within two blocks. Consolidation would provide \$625,000 in annual rent. Accordingly, consolidation offers a potential for significant cost savings. Based on the experience of the State of California, a five to eight percent reduction in occupied space can be achieved through consolidation. A comprehensive strategic asset

management program which could mandate such consolidation could result in annual cost savings of approximately \$5 million.

Savings from rent subvention. The County is entitled to Federal subvention (subsidy) for rent associated with certain uses (i.e., the Department of Children's and Family Services). The rent subsidy is not available if such programs are operated in County-owned facilities. A comprehensive strategic asset management program which could mandate that "subvented-rent-uses" are always located in leased facilities, would result in significant annual cost savings and free County-owned facilities for disposition with estimated revenue generation of \$4.6 million).

3. Immediate Action Required. The Board of Supervisors should initiate a bold plan to assure realization of these savings. The following action should be taken immediately.

Adopt an asset management mission statement that will provide a basis for a strategic, systematic and proactive asset management system. (Recommendation #1)

Adopt asset management goals to maximize efficiency in planning and management through cooperation and coordination between users. (Recommendation #2, a,b,c)

Develop a comprehensive real property land holdings information system. (Recommendation #9)

Develop a strategic asset management plan that balances goals of operations, revenue generation and financing. (Recommendation #11)

Seek legislative changes in Federal, state and local statutes, rules and regulations which limit the County's ability to manage, control and dispose of its real property. (Recommendation #14)

Appoint a Head of Asset Management who will be responsible for implementation of the asset management program. (Recommendation #20)

Require quarterly progress reports (Recommendation #24)

4. Strategic Asset Management is Critical. Implementing a comprehensive strategic asset management program would enhance utilization of County assets.

No accurate inventory of County assets exists. As was recently the case with the State of California and the City of Los Angeles, no accurate inventory of County real estate assets exists. Development of an accurate inventory system is a critical first step in a comprehensive strategic asset management program.

Cash flow for current operations. A high percentage of County real estate assets (47.8% of occupied area, including most of the larger and more prestigious properties) have been "lease financed" with cash proceeds allocated primarily to current operations rather than reinvested in capital projects. This policy is inconsistent with sound long-term asset management strategy and should be carefully evaluated as part of a comprehensive strategic asset management program.

Aging facilities are costly. The average age of County facilities is 30 years. The significant operating, maintenance and repair/replacement costs associated with this aging inventory should be carefully evaluated as part of a comprehensive strategic asset management program.

5. Current Asset Management Initiatives; Previous Reports Ignored. Several asset management initiatives are underway, including: (1) the addition of retail tenants in County properties; (2) ground leasing of County land and development of underutilized land; (3) proposed legislative reform of the public auction requirement for selling surplus property; and (4) development of a work plan to create a comprehensive real property information system. The first three initiatives could provide additional revenues for the County in the short term. The fourth initiative, although costly, is essential to an efficient asset management system. However, although implementation of a strategic asset management program has been recommended to the Board in five major reports since 1983, these reports have largely been ignored. □

## 6. Specific Recommendations to Facilitate Savings.

### THE MISSION OF ASSET MANAGEMENT (Section IV; page 13)

#### 1. Adopt the following mission statement:

The Mission of County Asset Management should be the comprehensive planned management of the County's diverse portfolio of real estate to assure optimum use, considering financing and funding sources, for the County's operations, and maximum value from the excess.

This mission statement will be the basis for a strategic and systemic proactive real property management system.

### THE GOALS/GENERAL PROGRAM DESIGN OF ASSET MANAGEMENT (Section V; page 13)

#### 2. Adopt the following asset management goals:

a. The County's Asset Management program will be designed to provide the most efficient level of services to the citizens of Los Angeles County by insuring that County property has its highest and best use, within the context of the County's mission. (Efficiency)

b. The County's Asset Management program will be designed to maximize cooperation, coordination, and consolidation opportunities, both within and without the County. (Cooperation, Coordination, and Consolidation)

c. The County's Asset Management Program should be designed to insure that the County hold and manage property, either owned or leased, in an efficient and effective manner and dispose of property that is not needed for County operations. (Planning, Operations, and Management).

d. Where possible, County facilities will be used as a catalyst for the economic revitalization and improvement in the quality of life for the citizens of the County through the operating departments of the County. (Social Contribution)

3. Direct the CAO to develop an incentive policy that enables departments to retain a percentage of any verified revenues or cost savings generated in the efficient management of their property. This policy should provide for individual and group incentives for superior proactive real

estate management performance. This savings should be determined subject to underlying financing and funding obligations and validated by the CAO based upon an objective monitoring system that provides necessary detail for the departments to understand the program and for the Board to make informed decisions.

4. Direct the CAO to identify portions of increased revenues or cost savings to provide necessary "seed money" to accomplish relocations and consolidations designed to produce future revenue and savings.

5. Direct the CAO to insure that the CAO's Asset Management function, which includes the Leasing Activity recently transferred from ISD, provides for a County-wide centralized point of control for making and implementing real estate decisions..

6. Direct the CAO to work with the Departments of Public Works, Libraries, Parks and Recreation, and Beaches and Harbors to establish and distribute procedures to County departments that implement centralized coordination of real property management.

7. Direct the CAO to establish specific criteria, such as space standards, cost per square foot, etc, for the optimum utilization of County property.

8. Direct the Treasurer/Tax Collector, in coordination with the CAO and Auditor Controller, to review, revise and recommend comprehensive asset management policies.

#### INFORMATION SYSTEMS (Section VII; page 18)

9. Direct the CAO to complete a comprehensive real property land holdings information system using a relational database, to include the assets of Beaches, Parks, and Public Works. This system should support the inventory being developed for County-owned assets and should accommodate and be integrated with the planned geographic information system (GIS).

10. Direct the CAO, in coordination with the Auditor Controller, to establish a methodology that provides for a property-by-property accounting that tracks the necessary variables including costs, estimated current market value, internal rent, revenues, etc., recognizing that full implementation can not be accomplished prior to the completion of a comprehensive property inventory.

#### PLANNING (Section VIII; page 21)

11. Direct the CAO to develop a Strategic Asset Management Plan (SAMP) that balances the goals of facilities, operations, personnel, and financial managers. Within the context of this Plan consider the following:

a. Maximize potential sources of outside funding. For example, consider how to structure the DPSS and DCFS requirements currently housed in owned facilities to be supported by Federal and State subvention.

b. Develop a process by which the County will routinely and periodically renegotiate concessionaire agreements to insure that rates and terms are consistent with market conditions.

c. Develop a plan for maximizing revenue generation by adding retail tenants at high traffic County-owned facilities or high traffic County locations and a process for reviewing the performance of the retail tenancy program with the objective of considering expansion, if demonstrated to be successful.

d. Address the longer-term strategies of asset disposition, asset-based financing, leasing of County-owned assets, and public/private joint development.

12. Direct the Auditor Controller, in coordination with the CAO, to develop measures of performance for lease audits.

13. Direct the CAO to specifically consider consolidation into owned facilities.

14. Direct that the County Counsel analyze Federal, state and local statutes, rules and regulations which limit the County's ability to manage, control and dispose of its real property and recommend legislative changes as necessary to facilitate implementation of the asset management program.

ANALYSIS (Section XI; page 28)

15. Direct the CAO to implement the concept of rent charge back.

16. Direct the CAO to review all lease and concession agreements for adjustment to market lease rates. Priority for this review should be based on upcoming contract cancellation or expiration dates.

17. Direct the CAO to develop policies and procedures to review the rental market relative to County occupancies with the objective of exercising early cancellation provisions in existing leases, renegotiating rents and relocating activities.

18. Direct the CAO to meet with Federal, State and municipal representatives to discuss shared government facilities and possible consolidation.

19. Direct the CAO to determine whether including facility maintenance costs within leases is cost effective.

#### IMPLEMENTATION (Section X; page 39)

20. Direct the CAO to appoint a Head of Asset Management who will be responsible for implementation of the Asset Management Program.

#### MANAGEMENT (Section XI; page 40)

21. Direct the CAO to establish a systematic preventive maintenance program to avoid the accumulation of long-term maintenance costs and to recommend a plan to finance such maintenance.

22. Direct the CAO and department heads to identify specific funds for real property maintenance, and to restrict the use of those funds.

#### MONITORING (Section XII; page 41)

23. Direct the CAO to develop a methodology to monitor performance of County real estate.

24. Direct the Economy and Efficiency Commission to meet with the CAO, and any other agencies or departments, as appropriate, to assist in implementing the asset management program and to report back to the Board quarterly. The first quarterly report should establish a project management timeline for implementing the strategic asset management program.

#### REVISION (Section XIII; page 43)

25. Direct the CAO to identify changes, modifications or additions to Federal, State and local legislation and/or policies necessary to enable a business-like disposition of surplus assets. For example, the requirement that surplus property must be leased at auction to the highest bidder.

#### FUTURE STRATEGIC DIRECTION (Section XIV, page 44)

26. Direct the CAO to incorporate within the Strategic Asset Management Plan the concepts of intergovernmental coordination and cooperation. □

## II. INTRODUCTION

### Authority

At the Budget Committee meeting held June 14, 1995, on a motion of Supervisor Gloria Molina the Board of Supervisors "...requested the Commission with the assistance of Jack Kyser, Chief Economist for the Economic Development Corporation of Los Angeles County, to review the Chief Administrative Officer's report on Revenue Potential of County-owned Real Property Assets, and return to the Board with information prior to Budget Deliberations." This action requested the following:

- a) Determine whether the 99.8 percent of properties cited in the CAO report can be used in any way to generate revenue for the County;
- b) Recommend a strategy to determine the highest and best use of County properties in areas where demand is high;
- c) Provide the Board with a report that identifies savings that could be generated from reduced lease costs and rental renegotiations currently being studied.

### Definition of Terms

To clarify the means of achieving savings recommended in this report the following terms should be defined:

Asset Management is the active search for ways to increase the value of real estate to the County.

Asset management is performed at the portfolio, rather than the facility, level. It includes responsibilities for site selection, acquisition (by purchase or lease), management and control of lease renewals, determination of idle resources and the disposition of real property.

Facility Management is the function of housing County space users in appropriate facilities. This function is reactive rather than proactive. Facility management responds to the requests for space needs rather than suggesting cost effective operations.

Real Estate Management is the organization which provides real estate services to the County.

Property Management is the ongoing maintenance of facilities at the individual asset level.

## Project Background

Over the past eleven years, several organizations have suggested improvements in the way the County manages its assets. These organizations have made recommendations that would have not only generated cost savings, but would have also established an effective system for managing the large asset base of the County. To date few of these recommendations have been implemented or their benefits realized.

The current fiscal environment faced by the County provides increasingly compelling reasons to review the economic potential of the County's real estate portfolio, the management potential of an effective asset management strategy and the current market opportunities. Consideration of these items can significantly impact the future direction of how assets will be managed in the County to insure the fulfillment of its public service mission. Although the County is not in the real estate business per se, the size, complexity and financial commitment to its real estate holdings dictates that real estate assets be managed just as efficiently as cash, receivables, or debt.

The responsibility to manage real estate assets effectively has been recognized for more than a decade within the County. Responding to an effort to increase the efficiency of maintenance service, the Board of Supervisors in 1985 unified its property functions by consolidating the Building Services, Communications, Facilities, and Mechanical Departments into a single Facilities Management Department.

In December 1986, a report prepared by the Economy and Efficiency Commission entitled, Property Management in Los Angeles County, pointed out that the new Facilities Management Department also had to perform non-related functions that were not relevant to the real estate management. The Commission felt that property management was not fully unified since the function was fragmented between the Facilities Management Department and the CAO. This lack of unification created a lack of clarity between the layers of administrative coordination and project execution. The most important concern at that time was that neither department was subordinate to the other, creating confusion in assigning accountability for the accomplishment of a project. The result was a capital

improvement program with no one in charge and with the County continuing to manage these assets from crisis to crisis.

The central conclusions of this 1986 study were essentially the same as those of an Economy and Efficiency Commission 1983 study of County organization:

1. The CAO has no authority to implement policy or organizational changes for any department of the County except its own.

2. A strategy of simply merging existing departments which incorporate mismatched functions is defective.

In December 1988, The Commission issued a report to the Board which recommended changes in the responsibilities and organization of the Chief Administrative Office and some County Departments. It also recommended the establishment of an asset management organization, initially reporting to a newly created Internal Services Department. The recommended asset management organization included certain major County land holdings from various departments, and would be responsible for developing and implementing a comprehensive, strategic County-wide asset management plan which would optimize the generation of revenue from the County's real estate holdings and other major physical assets. This recommendation has not been implemented. The asset management component of the County's real estate operations has remained with the CAO. Recent actions by the Board have further centralized real estate responsibilities within the CAO. This action has created an environment that will facilitate the implementation of this recommendation.

In 1991 the Economy and Efficiency Commission further clarified its position on the real estate issues facing the County. The key components of its recommendations were: (1) that the County understand the economic costs of holding real estate, and (2) that there be economic incentives for the businesslike management of the County's real property. To achieve these objectives the Commission made recommendations in areas of establishing policy, creating a Real Property Management Steering Committee, clarifying organizational responsibilities, establishing an accurate inventory, and developing departmental economic incentives. As a result of these recommendations a facility inventory, encompassing primary facility data for billing purposes, was expanded, along with a partial decentralization of space costs which reside in the County's rent expense budget.

In October 1994 the Quality and Productivity Commission and the Chief Administrative Office submitted another study on Asset Management. This study reviewed the County's real property

assets, their management and ways they could generate new revenues or cost savings. The results of this effort was a determination that decentralization of the real property function has resulted in a significant deterioration of the County's real property assets, creating a liability risk and the probability of increased future expenses. The Quality and Productivity Commission felt that since the County lacks a coordinated means of planning, use, maintenance and development of its assets, there can be no County wide short-term or long-term planning. The study stated that there is no centralized listing of the inventory, from which such plans could evolve. This study concluded that significant cost savings in the short-term and new revenues over the long-term were possible with proper management and maintenance of assets. It also recognized that long-term planning was not performed.

Recommendations made by these reports have not been implemented and problems identified as early as 1983 still exist. This study attempts to recognize the work of previous studies and the progress made to date. It also attempts to identify the specific steps necessary to implement an efficient asset management program.

### III. STUDY DESIGN

The primary motivation for this study was to consider the development of strategies for adoption by the County in the management of its real estate assets to address the need for generating revenues and reducing costs. It establishes a framework for these activities and provides examples of how objectives can be accomplished. In developing this approach, the study undertook a review of the concepts involved in determining how real estate decisions are made and how they can affect the financial conditions of the County.

This study presents examples of specific asset analysis, with the objective of determining their most effective use. It also provides an asset management model designed to improve the understanding of the continuous process of asset management. The model identifies those areas that can be impacted to result in revenue enhancement or cost savings.

With limited resources, this study attempts to build upon the previous work in this field, to reemphasize the need for the implementation of previous recommendations, to develop specific recommendations for the development of asset management strategies, and to identify alternative

real estate opportunities. Without a program structure to manage the County's property assets, any efforts in this field are destined to distract management, reduce productivity, increase costs, confuse revenue potential, and limit the opportunity for the effective utilization of these resources. This report focuses on the asset management opportunities available to the County, as well as the constraints which will limit strategic implementation. It also considers innovative asset management techniques that are used by other governmental agencies.

The Economy and Efficiency Commission was assisted in this review by Ms. Patricia Flynn, of Coopers and Lybrand and Mr. John Salmon, former Director of the Governor's Office of Asset Management. The Commission was further assisted by County staff from the Chief Administrative Officer (CAO), Internal Services Department (ISD), County Counsel, and Public Works. These individuals provided information and analysis on County-owned and leased assets. In addition they provided information on the workings of the asset management function within the County. Discussions were held to identify the purpose of the study, the range of asset management opportunities, constraints on strategic alternatives, potential information sources, and the past and pending efforts undertaken to increase the efficiency of real estate asset management.

#### IV. THE MISSION OF ASSET MANAGEMENT

Lacking any previous or current identification of the mission of asset management, this study proposes that Los Angeles County adopt a modified version of the mission definition currently in use by the State of California and the City of Los Angeles: The comprehensive planned management of the County's diverse portfolio of real estate to assure optimum use, considering financing and funding sources, for the County's operations and maximum value from the excess.

#### Recommendation

##### 1. Adopt the following mission statement:

The Mission of County Asset Management should be the comprehensive planned management of the County's diverse portfolio of real estate to assure optimum use, considering financing and funding sources, for the County's operations, and maximum value from the excess.

This mission statement will be the basis for a strategic and systemic proactive real property management system.

Implementation: Immediately upon Board approval of this Report

## V. THE GOALS/GENERAL PROGRAM DESIGN OF ASSET MANAGEMENT

Asset management in the County must contribute to the strategic goals of the County. As a program it must shift its reliance from technical skills toward a recognition of the strategic concerns in this field. Executive management must not think of real estate just as space, but as a major resource supporting the productivity and goals of the County. Asset management should be based upon the principle that the County's facilities, whether owned or leased, represent a highly valuable real estate portfolio that must be actively managed.

The objectives of the County in managing its assets are complex since they must recognize both efficient operations and equitable distribution of resources as being important. In addition, a major focus of the County is to generate a social return, ie. jobs, social diversity, etc. By adopting a clearly stated philosophy toward real estate, the County will be better able to control costs and to effectively manage these assets. The establishment of goals, and a mechanism to achieve these goals, are driving forces in making effective real estate decisions. The City of Los Angeles Asset Management Policy is included as Appendix B to illustrate the approach taken by another jurisdiction in this field.

Since the County currently lacks an identification of the goals for Asset Management, this study proposes that Los Angeles County adopt the following goals for the use in managing its assets:

1. Efficiency - To provide efficient services to the citizens of Los Angeles County
2. Social Contribution - Where possible to serve as a catalyst for the revitalization and improvement of County services.
3. Cooperation and Coordination - To seek ways for the County to improve its asset management through improved coordination and cooperation, within and without the County.
4. Planning - To develop a strategic plan that will provide a basis for the effective management of property within the County.
5. Operations - To insure that the County holds property in a form, either owned or leased, that proves to be the most efficient and effective.
6. Management - To insure that County property is effectively utilized and managed in a cost efficient manner within the constraints of the County mission.
7. Consolidation - To pursue consolidation of facilities where possible.

The accomplishment of these goals requires that the CAO has the mandate and the authority to become the central real estate management organization responsible for the development of a proactive asset management system. The CAO should be responsible for the management of all of

the County's real property, except operating rights of way, to include long-range planning, financing, construction planning and oversight, disposal of excess property and joint development with public or private agencies. The specific tasks involving appraisal and acquisition are functions that reside with Public Works.

The development of this function/organization should include a revised and clearly defined real estate decision making process to insure that those involved in the process understand and carry through their assigned responsibilities. In the broad sense the process should involve three areas of activity and accountability:

1. Acquisition and divestiture, including identification of real estate investment needs, site selection, acquisition of property, identification and disposal of surplus property, and design decisions.
2. Finance, including capital budgeting and financial analysis.
3. Custodianship, including property management and real estate record keeping.

In each of these areas appropriate measurement and monitoring systems should be established to validate the performance in the following areas: additional revenues generated, value creation, cost reduction, and cost avoidance. The CAO should have authority, with overview responsibilities or direct control, over acquisition, management, and property disposition functions to include special development activities for parcels with substantial market potential. The unit should be managed by real estate professionals with both planning and finance experience.

The objectives of the CAO in this area should be:

- a. To provide both the Board and Department Heads with an awareness of real estate options within an overall strategic decision-making process.
- b. To maximize the value of the County's real estate assets, within the constraints of its mission, and,
- c. To provide knowledge or access to procedures for efficiently carrying out real estate decisions to:
  - minimize costs,
  - avoid costly lease errors that increase operating costs, and,
  - maximize returns on surplus property sales.

Recommendations:

2. Adopt the following asset management goals:

a. The County's Asset Management program will be designed to provide the most efficient level of services to the citizens of Los Angeles County by insuring that County property has its highest and best use, within the context of the County's mission. (Efficiency)

b. The County's Asset Management program will be designed to maximize cooperation, coordination, and consolidation opportunities, both within and without the County. (Cooperation, Coordination, and Consolidation)

c. The County's Asset Management Program should be designed to insure that the County hold and manage property, either owned or leased, in an efficient and effective manner and dispose of property that is not needed for County operations. (Planning, Operations, and Management).

d. Where possible, County facilities will be used as a catalyst for the economic revitalization and improvement in the quality of life for the citizens of the County through the operating departments of the County. (Social Contribution)

Implementation: Immediately upon approval of the Board.

3. Direct the CAO to develop an incentive policy that enables departments to retain a percentage of any verified revenues or cost savings generated in the efficient management of their property. This policy should provide for individual and group incentives for superior proactive real estate management performance. This savings should be determined subject to underlying financing and funding obligations and validated by the CAO based upon an objective monitoring system that provides necessary detail for the departments to understand the program and for the Board to make informed decisions.

Implementation: Within six months

4. Direct the CAO to identify portions of increased revenues or cost savings to provide necessary "seed money" to accomplish relocations and consolidations designed to produce future revenue and savings.

Implementation: Within six months.

5. Direct the CAO to insure that the CAO's Asset Management function, which includes the Leasing Activity recently transferred from ISD, provides for a County-wide centralized point of control for making and implementing real estate decisions..

Implementation: Immediately.

6. Direct the CAO to work with the Departments of Public Works, Libraries, Parks and Recreation, and Beaches and Harbors to establish and distribute procedures to County departments that implement centralized coordination of real property management.

Implementation: Within six months.

7. Direct the CAO to establish specific criteria, such as space standards, cost per square foot, etc, for the optimum utilization of County property.

Implementation: Within six months of the completion of the County-wide Inventory.

8. Direct the Treasurer/Tax Collector, in coordination with the CAO and Auditor Controller, to review, revise and recommend comprehensive asset management policies.

Implementation: Within three months

## VI. ASSET MANAGEMENT MODEL

### Introduction

Whether recognized or not, as a result of its occupancy of owned and leased facilities, the County is in the business of real estate. Over the last five years, annual costs to the County of occupying property have continued to rise. Unfortunately, even though there have been numerous studies and reports on the impacts of these rising costs, the County has not developed a strategic asset management program to effectively manage these assets or to develop a meaningful real estate strategy. As a result, there is a continuing inability to appropriately address asset oversight and cost control. The opportunities, or the lost of opportunities, inherent in not understanding the importance of proper real estate decision making will apply equally to both owned and leased facilities.

To illustrate these possibilities, in the early 1990s the State of California undertook a review of 700 of their properties to determine whether they were under-used or inadequate for current program needs. Of the 700, 125 of the properties were either under-used or inadequate. Further analyzing these 125 properties, the California State Department of General Services determined that 32 of the properties were either surplus or under-used. Based upon their assumptions and calculations it was estimated that the State could generate between \$51.2 million and \$115.2 million annually.

Although this estimate overlooks the complexity of evaluating property, it does provide an idea of the magnitude of the potential yield that might be achieved from the aggressive management of state property. The City of Los Angeles has stated that, "Our experience with the State of California and other large governmental space users is that cost reductions in the order of 25% are possible while simultaneously providing better space and better service to the public."

In another recent example, the City of Riverside Development Department in fall of 1995, will complete the California Tower. The California Tower will provide office space for seven state agencies and will employ nearly 500 people. In addition, this renovation will create opportunities for new stores, service firms, and restaurants. As one in a series of cooperative projects, many based on public partnerships, it is designed to expand the presence of State and Federal agencies. This project was able to consolidate governmental office space requirements, maintain cost control, revitalize a key retail block in Riverside, and improve the private-sector real estate leasing market through the occupation of more than 120,000 sq ft which might have gone empty, thereby depressing prices. A key to the success of this project lies in the private sector approach taken by the State Department of General Services and to the concept that State tenants are treated as valuable assets, rather than "space pawns".

The model

It is clear from the preceding examples that numerous actions can be taken by the County in the management of its assets that would improve both the economic and social return. To illustrate this point consider that a difference in occupancy cost of \$5 per sq. ft. on 100,000 sq. ft. for a 20 year term creates a savings of \$10 million or a difference of \$2 per sq. ft. on 500,000 sq. ft. for 20 years would bring in \$20 million. This report proposes to establish a conceptual framework within which an analysis can be presented and within which ancillary issues can be addressed. The development of an asset management cycle provides this framework. This cycle, presented below, addresses those requirements that have to be defined and refined by the County in the management of its assets.

Chart I  
ASSET MANAGEMENT CYCLE

PLAN

REVISE

ANALYZE

INFORMATION SYSTEMS

MONITOR

IMPLEMENT

MANAGE

## VII. INFORMATION SYSTEMS

Information systems provide the base from which decisions on each of the elements shown on Chart

I are made. Without accurate and current information, asset management decisions will not only lack credibility, but may also have the potential for incurring significant costs, either real or opportunity. The criteria to be used in the development of an effective information system are to implement a system that supports the requirements of the County, produces data that facilitates management decisions, and is cost effective.

There is general agreement in the field of asset management, and in previous recommendations made

to address this problem, that the first step toward insuring the effective management of real property

is the creation of an accurate inventory, one that is more sophisticated than a file folder containing

a list of most of the properties held by the County. The CAO recognizes this requirement and has

reported that they are working on building a geographic information system (GIS) to be used as a tool for inventorying and conducting strategic planning. With this system the CAO will pursue both

the short-term and long-term objectives of:

- Identifying and assembling an inventory of all County owned and leased real property from data collected from the Assessor, Internal Services Department, Public Works and other major property holding departments;

- Pinpointing the location of every piece of property on a digital street map of Los Angeles County;

- Depicting all or any combination of these properties in relation to various GIS "overlays"

such as political or service area boundaries, demographic data, and real estate trend data, and

- Building a data base of building operating costs and market validation for each individual asset.

The Economy and Efficiency Commission, consistent with its previous recommendations and those of the Quality and Productivity Commission, concurs with the efforts of the CAO to develop an inventory. While supporting this effort, the Commission needs to point out that having the capability or a means of creating an inventory does not insure that an effective inventory will be created. An inventory provides only a static profile of real estate holdings. Prudent decision making requires monitoring the collection of data on such items as, the changing costs of utilities, insurance, repairs and maintenance; reserves and debt service; gross possible income; vacancy; current market value; and occupant use. To assess performance accurately, the County must have the capability to segregate real estate from non-real estate operating data. It is extremely difficult, if not impossible, to make informed real estate decisions without an independent real property management information system.

Conceptually, the design of an information system to support the planned inventory must be able to incorporate high levels of speed, power, flexibility and versatility - yet still be cost effective to implement. Many organizations with similar concerns in this area are purchasing and using a number of functionally specific software programs for the purpose of transferring data to a central database or other central information source. The key ingredient to developing a County-wide information system, which has been recognized by the CAO, is a relational database. This form of database has three main advantages over the traditional flat file database: 1. reduction in data redundancy, 2. enhanced data management capabilities, and 3. program and data independence. The end result of a fully integrated system should be increased staff efficiency. Side benefits should include reduced errors and the efficient storage and retrieval of historical data that can be used to develop trends and presentation materials.

Specifically, the design of a system should enable an asset management organization to review:

1. the County's real estate assets for idle space,
2. leases that are out of line or up for renewal, and
3. changes in the market place or value of the property that shift the best use of the property from its current use.

This approach requires a significant commitment of resources to provide readily

accessible up-to-date consolidated records of all properties owned and leased, including location, use, general description, size, age, acquisition cost, capital improvements, capital needs, operating expenditures, and market value of prime County holdings with opportunities for alternative use. With this information options can be exercised that maximize the available alternatives, such as was accomplished in the previous City of Riverside example. Without the development of such a system, the County will be severely hampered in its efforts to either maximize the revenue potential available within the assets controlled by the County or to significantly reduce the costs of managing these assets. The County can develop market leverage only when it has the freedom to select from competing opportunities.

Real estate financial data may be organized on a property-by-property basis, by property categories, or in defined pool of properties. Property-by-property accounting is the most desirable since it enables management to evaluate each piece of real estate individually and to combine figures on individual properties when appropriate. Real estate is generally bought, sold, and leased property-by-property. Category and pool accounting have a tendency to obscure physical and financial problems, which makes it difficult to distinguish real estate performance from other management performance.

Once an inventory has been created the County can assess the impact of the cost of the real estate facilities it owns or leases on the total County. It can determine what percentage of the County's revenue, or costs, are attributable to real estate functions or how the asset base can impact the County's borrowing powers.

#### Recommendations:

9. Direct the CAO to complete a comprehensive real property land holdings information system using a relational database, to include the assets of Beaches, Parks, and Public Works. This system should support the inventory being developed for County-owned assets and should accommodate and be integrated with the planned geographic information system (GIS).

Implementation: Within six months

10. Direct the CAO, in coordination with the Auditor Controller, to establish a methodology that provides for a property-by-property accounting that tracks the necessary variables including costs, estimated current market value, internal rent, revenues, etc., recognizing that full implementation can not be accomplished prior to the completion of a comprehensive property inventory.

Implementation: The methodology to be initiated within one month and completed within six months of the completion of the County-wide inventory.

## VIII. PLANNING ELEMENT Chart II

### Planning Element

After addressing the requirement for the establishment of an inventory and having made the assessments that would accompany this effort, the County can begin the asset management process

by initiating the development of a plan. Planning should begin with an understanding of the County's mission, goals and the long-term direction of the County. Understanding that change is inevitable, the planning process recognizes that good plans require general guidelines and policies,

not set rules. Facility needs should be matched against the short and long-term budgets of the County, including the approved forecasts of growth in facility requirements or in restructuring.

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plan should enable a comparison of facilities that are currently owned or leased.

The strategic plan is a current, long-range business plan, uniquely adapted to the requirements of managing the County's assets. It should be a dynamic document, incorporating alternatives for change, that is generated from bottom up data to assure the implementation and balance the often-

competing goals of different groups. Such an effort faces three challenges: 1. an uncertain economy

and real estate market, 2. rapid technological change, and 3. government downsizing.

Focusing the overall County goals and objectives is critical to the development of a Strategic Asset

Management Plan (SAMP) that balances the goals of facilities, operations, personnel, and financial

considerations. The following factors, if handled efficiently, can contribute to the asset management

department's success: 1. a strong coordination between senior management and the asset management organization, 2. a documented SAMP, 3. a sophisticated process to identify and analyze

asset redeployment opportunities, 4. strong coordination between real estate management and the financial department, and 5. a means of monitoring identified property performance criteria.

Strategic planning is required to insure that the general magnitude, the specific types of property, and the utilization of property within the County make sense from a business standpoint. This assessment of the County's properties should take place during the planning cycle. Appendix C illustrates a methodology for evaluating the assets owned by the County against available strategies

and applicable constraints. The analyst, in reviewing this methodology, will be able to address an

overall strategy and structure of the County's Strategic Asset Management Plan, will be able to

evaluate, by property, which strategies would be available and which constraints apply to a particular facility, and will be able to facilitate an identification of the lowest cost alternatives.

The second level of planning, or the tactical planning phase, which utilizes the approach discussed above, involves an assessment of the economics associated with a specific project. Early stages involve reassessing the definition of the service and its strategic direction, examining the business climate outlook, reviewing operations and identifying broad issues. This stage involves detailing action programs, fine-tuning the financial projections and examining and dealing with the risks involved. The approved strategic plan then serves as a basis for the development of an asset management budget.

As with most public entities, Los Angeles County has approached the management of its real estate needs in a reactive and fragmented manner. The County's approach has centered on departmental space requests, rather than on an overall consideration of consolidated needs and presence of the County. While a certain amount of fragmentation and reactive satisfaction of space needs may occur, the real need lies in the development of a strategic real estate facilities plan. The absence of such a plan forces all decision making to be ad hoc and deprives the County of efficiencies and economies to be achieved by viewing its real estate needs in a broader framework. For example, to the extent that the County is now acquiring modular furniture and other personal property under the terms of occupancy leases, it is doing so with the lessor's purchasing power and financing rates, which may well be in excess of purchase and financing costs which are otherwise available to the County.

#### General Discussion of Alternative Strategies

Real estate value maximization and cost effectiveness can be attained in two ways: by maximizing the revenue-generating potential of the County's assets and by reducing costs. There are several revenue enhancement strategies that can potentially be applied to the County's asset base.

In the short term, the County should seek to maximize non-General fund lease revenues. The County currently receives rent subsidies for the Department of Public Social Services (DPSS) and the Department of Children and Family Services (DCFS). A preliminary search of the County's existing database shows that ten departmental occupancies totaling 591,271 square feet are currently housed in owned facilities. The existing potential for savings could be realized by moving the

subvented occupancies out of owned space to leased space, while moving leased occupancies currently supported by general funds into the owned facilities. With this strategy, the County can realize a net savings of the costs of general funds leases. To illustrate the potential for savings, assuming that all of these occupancies can be moved to leased space and that leased occupancies can be moved into these owned spaces and that the space is housed at a average rate of \$1.50 per square foot per month, the annual savings would be more than \$10,640,000.

Additional short term revenue enhancement can be potentially achieved through the periodic renegotiation of concessionaire agreements to make sure that both the rates and terms are consistent with current market conditions. The County should research and react to current market conditions and to the most effective lease/licensing structures to insure that this revenue stream is being maximized.

There are several revenue enhancement strategies that could be implemented over a longer period of time. Although obviously longer to implement, these strategies offer potential revenues that are a significant and important part of an effective asset management program. These enhancement strategies include asset disposition, asset-based financing, and the leasing of County-owned assets.

Disposition of assets requires consideration of long term space requirements in the context of all owned and leased assets, as well as market conditions. Effective disposition decisions can only be made when all of these factors are considered concurrently. The existing information systems supporting the County real estate function are inadequate to enable effective asset disposition.

Asset-based financing allows the County to raise cash secured by owned real estate assets. This strategy is primarily a method of making cash available, rather than enhancing asset value. Once an asset is financed, the terms of the financing will significantly limit future strategic deployment. A prudent asset management policy limits the use of financing proceeds to fund capital projects. In the past, however, the County has chosen to use financing proceeds to fund County operations.

The County should consider maximizing revenues by leasing additional space to private sector tenants. For example, the installation of ATMs, kiosks, convenience stores, fast food outlets, and other tenant-service providers will not only increase revenue, but can also offer convenience and

an improved quality of life to those utilizing County facilities. The rental rates and terms for these users should reflect private sector market terms.

Long term revenue strategies include the potential for public/private joint development of County-owned sites. Successful joint development is a highly opportunistic undertaking which depends on the strength of market conditions and the quality of the site and the joint development team. However, as with asset disposition, identification of joint development opportunities requires a detailed understanding of the County's current and long term asset needs. As has been pointed out previously, effective public/private joint development cannot be implemented without significant information systems support.

Cost reductions can be implemented in both the short and the long term. Short term cost reduction strategies include renegotiation of all leases, where the County is lessee, that are at above-market rents. As part of the research for this study, a sample of ten leases chosen at random were compared to market value for rental rates and terms. The County leases reviewed were at measurably higher rates than comparable rates in the area. As discussed in a following section, this variance may be attributed to the cost of over-standard tenant improvements or other non-real estate capital costs. Assuming, however, that the leased portfolio is an average of \$0.10 per square foot per month over market, the annual savings on the leased portfolio would be over \$6,000,000 with general fund lease annual savings of \$2.3 million. (This assumption is presented to illustrate the point, and should not be used in making budgetary decisions. Further in-depth analysis would be necessary to establish the actual savings.)

The County should conduct lease audits for general funded leases to make sure that all common area expenses are being properly charged. Private sector investors have found that lease audits often uncover overcharges which, depending on the terms of the lease, can be rebated for prior years and may represent on-going savings for future years.

Long term cost reduction depends on the ability to understand long term occupancy requirements and the potential to reduce the amount of space required to house County activities and services.

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significant opportunity for savings comes from the possibility for consolidating occupancies. This strategy can result in lease avoidance costs and the maximization of the use of owned facilities. Previous experience of other public agencies indicates that consolidation can yield a five percent reduction in total occupancy costs. Assuming a five percent reduction in leased space utilization at an average rate of approximately \$1.00 per square foot per month, the annual potential savings due to consolidation of leased office space could be \$3.0 million. (This assumption is presented to illustrate the point, and should not be used in making budgetary decisions. Further in-depth analysis would be necessary to establish the actual savings.)

There would also be a one time revenue of \$15.3 million from the sale of County-owned assets, if the County could aggregate these space savings into readily marketable properties. To accomplish this aggregation of space will require "seed money" to finance the necessary relocation of County programs.

A review of the ISD database material of owned and leased assets indicates potential opportunities for consolidation. For example, the County owns several buildings in the 500 block of South Vermont in the mid-Wilshire District. The owned buildings represent approximately 211,500 square feet of space. In addition to these owned facilities, ISD has estimated that the County leases approximately 400,000 square feet of space within a one mile radius of the owned facilities. Given these circumstances, it appears that a significant portion of the leased occupancies could be consolidated into County-owned facilities. The balance of leased occupancy could be consolidated into other facilities. Using this strategy the County would gain the financial leverage associated with a large occupancy in a very weak market, as well as the physical efficiencies gained from co-location. The concept of consolidation should be broadened to include other public agencies. For example, both the City of Los Angeles and the County occupy offices in the 400 to 500 block of Shatto Place. Both agencies have spaces with multiple offices with similar occupancy profiles. By consolidating these public occupancies, both the City and the County could significantly reduce the amount of space under contract, as well as gain the financial leverage associated with a larger occupancy.

Asset Management Constraints

A central principle of the County's asset management strategy is to recognize that the County must fulfill its obligations to provide services to its constituents. In this context, asset management should not be looked at simply as a cost reduction exercise, but rather as a means of improving the cost effective provision of County services. Thus, when considering strategies and the constraints upon those strategies, constituent service must serve as the guiding principle.

The asset management program must recognize that the County works under legal and policy constraints that will limit its flexibility in developing strategic options. The most significant of these restrictions are summarized below.

Owned assets can be sold subject to the County's continuing need for the property in its delivery of services. The sale of owned assets is subject to statutory requirements that are unique to public ownership, as well as normal asset management concerns. Statutory restrictions include the Park Preservation Act and the Los Angeles County Flood Control Act of 1915; public financing encumbrances; and Federal and State subvention requirements for restitution in the event of a sale. In addition, publicly owned assets can be subject to long term leases at low or no economic value, severely limiting the potential return to an investor. Asset management concerns include local entitlement restrictions; the extent of deferred maintenance; and the presence of hazardous materials or other environmental contamination.

Leasing owned assets involves many of the same constraints enumerated for the sale of owned assets. Current law requires that owned assets be leased through an auction process to the highest bidder. This requirement limits the County's ability to act in the same manner as a private sector owner that would quickly meet the needs of the marketplace. In addition, the leasing of owned assets would require that the County assume the role of landlord, negotiating rental rates and terms, and maintaining and operating properties to market standards.

The County also has the ability to sell owned assets (subject to the constraints identified above) and lease the property back from an investor. This approach requires that the County's rental payment meet the return requirements of a private investor which, in some cases, may result in higher annual occupancy costs. The sale/leaseback approach is subject to limitations on subvention

claiming if occupied by subvended Departments (Public Social Services and Children & Family Services).

The County has the ability to place long-term financing on owned properties to raise cash. The ability to borrow against owned assets is subject to the constraints discussed under asset disposition, above, as well as real estate and financial market conditions. The conditions could include the fair market value of the asset, the County's credit rating and debt limitations, and the borrowing and transaction costs.

Long term ground leasing is a strategic alternative for use with underutilized land assets. In addition to the constraints discussed under asset disposition, long term ground leasing is subject to the entitlement constraints of the local jurisdiction; the ability to attract a quality development team; general real estate and economic market conditions; and the availability of project financing.

Asset management can be constrained by the types of assets in the portfolio. Approximately 57 percent of the County's owned and leased real estate portfolio (See Table 1, page 20) is in the form of special use assets. These assets are not readily marketable due to the limited alternative uses or the specialized nature of the building or tenant improvements. Sale of special use assets is subject to all of the constraints listed under asset disposition, as well as marketability limitations.

## Recommendations

11. Direct the CAO to develop a Strategic Asset Management Plan (SAMP) that balances the goals of facilities, operations, personnel, and financial managers. Within the context of this Plan consider the following:

a. Maximize potential sources of outside funding. For example, consider how to structure the DPSS and DCFS requirements currently housed in owned facilities to be supported by Federal and State subvention.

b. Develop a process by which the County will routinely and periodically renegotiate concessionaire agreements to insure that rates and terms are consistent with market conditions.

c. Develop a plan for maximizing revenue generation by adding retail tenants at high traffic County-owned facilities or high traffic County locations and a process for reviewing the performance of the retail tenancy program with the objective of considering expansion, if demonstrated to be successful.

d. Address the longer-term strategies of asset disposition, asset-based financing, leasing of County-owned assets, and public/private joint development.

Implementation: To be initiated within six months, with completion six months after the completion of the County-wide inventory.

12. Direct the Auditor Controller, in coordination with the CAO, to develop measures of performance for lease audits.

Implementation: Within six months.

13. Direct the CAO to specifically consider consolidation into owned facilities.

Implementation: Within one year

14. Direct that the County Counsel analyze Federal, state and local statutes, rules and regulations which limit the County's ability to manage, control and dispose of its real property and recommend legislative changes as necessary to facilitate implementation of the asset management program.

Implementation: Within six months

## IX. ANALYSIS ELEMENT

### Chart III

#### Analysis Element

An important factor in evaluating the ongoing return on real assets is the explicit consideration of internal benefits derived from real estate as a factor of production in the form of a rent charge back.

Accounting for internal rent is a practice among two-thirds of corporations, but very uncommon among municipal property managers (15%), despite the fact that most publicly held properties are held for the use of the municipality and are not expected to be revenue generating.

As has been stated in previous Economy and Efficiency reports, formally dealing with internal rents is a necessary ingredient in the ongoing property analysis process.

#### Overview of the Status of County Assets

The County of Los Angeles controls approximately 41.7 million square feet of office, industrial, and special use building assets, as well as more than 14,500 acres of land in the form of parks and vacant land. This information was derived from the ISD database, and does not consider the Public Works assets or the housing assets of the County Development Commission. The Marina del Rey ground leases are also not included in this inventory.

Table 1

SUMMARY OF FY 1994/95 LOS ANGELES COUNTY REAL ESTATE ASSETS  
(Amounts in square feet of business)

	Leased	Owned	Financed	Total
All Assets	5,042,021	20,394,363	16,261,313	41,697,697
Office	3,671,890	2,882,000	2,871,695	9,425,585
Warehouse/Industrial	438,156	1,389,196	1,036,553	2,863,905
Special Use	731,043	11,660,931	11,549,224	23,941,198
Cultural Use	200,410	3,201,855	803,841	4,206,106
Aviation				

N/A  
1,027,311  
N/A  
1,027,311

Beaches  
522  
233,070  
N/A  
233,592

Source: ISD

### Breakdown of Assets by Product Type

The County of Los Angeles owns and leases a large and diverse number of real estate assets ranging from small sheds in maintenance yards to large administrative facilities housing thousands of employees. Most of the owned and leased assets are under the control of the designated proprietor of the property, and described in a database maintained by ISD. There are additional County assets under the control of other departments. Examples include the rights-of-way and civil infrastructure under the control of the Department of Public Works, as well as the low income housing controlled by the Community Development Commission.

Asset classification focuses on the real estate under the control of ISD, described in a way that is meaningful to the general real estate community. The Economy and Efficiency Commission compiled a description of County assets in a August, 1991 report that described assets by departmental use, with quantity measured as square feet of land area. This asset description was also referred to in the April 21, 1995 memo from the Chief Administrative Officer to the Board. A departmental description of assets may be helpful for County use, but additional effort may be necessary to insure that a description of the asset base is done in a manner that is useful to the general marketplace to explore alternative strategic approaches to the use of the asset.

In addition to describing the County's property by the above, the 1991 report estimated a value of County property to be between \$22-40 Billion. This estimation has been criticized as inaccurate since the issuance of this report, but when asked for an estimate of property the County was unable to provide a better estimate. In the course of developing a real property inventory the County should be able to establish such an estimate. Recognizing that the previous estimate may be incorrect, until a more accurate estimate of property value is available from the County, it serves a purpose of establishing the magnitude of the issue being discussed.

Rather than look at the County's assets as they are used by each department, this review focused on the assets by type of use: office; warehouse or industrial; recreational facilities; special use assets such as libraries, law enforcement facilities, and health clinics; cultural facilities such as

the Music Center; aviation facilities; beaches; and vacant land. Our objective was to understand:

1. Which of the assets are owned and which are leased?
2. If owned, which are subject to financing or refinancing?
3. If leased, which are funded from the County General Fund and which receive State and Federal support in the form of rent subvention?

Each of these conditions is an important factor in determining the potential asset management strategies. In addition, the report recognizes that there are other legal and policy constraints which limit the ability of the County to acquire, lease, and dispose of property at will. The description of the County assets and potential management strategies which follow considers the potential of efficient asset management, given the existing constraints described in the previous section. Where appropriate, we have noted legal and policy reforms which will help the County achieve the efficient utilization of its assets.

## Management Strategies

### Strategies for Leased Assets

#### The Economy and Efficiency

Commission requested its staff to perform an analysis of the County's office leases over 20,000 square feet to determine variances, if any, with market rate rents for comparable office space in the immediate vicinity and, in the event adverse variances are identified, to recommend steps which could be taken to renegotiate such rent to current market levels.

Approximately 5.0 million square feet of all County occupied facilities are commercially leased which provides for the short term (customarily from five to ten years) space needs of the County. This contrasts with the long-term obligations and greater capital investment inherent in buying or building to meet the County's facilities needs. The current leasing program attempts to provide flexibility by matching and sizing its facility inventory in response to changing public service requirements, State and Federal mandates, and special one-time needs.

The County leases approximately 5.0 million square feet of building area, not including leases entered into for financing purposes. Leases are funded either from County general funds or from federal and state programs providing subvention for specific programs. Examples of facilities covered by subvented leases include service centers for the Department of Social Services and certain Department of Children and Family Services spaces.

Leased assets were reviewed by considering size of asset, as well as by funding source. Nearly half of the of the number of facilities being leased are smaller than 5,000 square feet. These leases are typically well-suited for consolidation with other uses. Subvention is used to fund the majority of the leased facilities larger than 20,000 square feet.

Analysis of the County's leased occupancy for Fiscal Years 1990/91 and 1994/95 shows an increase of 90,000 square feet. The average rental rate for the same period has also increased from \$8.70 in FY 1990/91 to \$11.82 in FY 1994/95. See Table 2 below:

Table 2

LOS ANGELES COUNTY OCCUPANCY AND RENT

Fiscal Year
Occupancy
Rent
Rent/SF
1990 Rent
Adj for CPI
Variance
1990-91
4,985,249
43,348,034
\$8.70
\$8.70
\$0.00
1994-95
5,043,160
58,115,033
\$11.52
\$9.79
\$2.73

Source: ISD

Note: Inflation assumed for this analysis to be 3% per year

The variance in lease rate from the adjusted CPI can be partially explained by some changes in County leasing policy. Starting in FY 1990/91, the County began actively pursuing the replacement of leases serviced by the County (net and split service leases) with full service or modified leases, thus, buying additional services previously provided by the County under the nomenclature of "leases". This pursuit resulted in 30% of the total leased space to be converted to full service leases during this period of time. Adjusting for this reallocation of service-buying methodology, Table 3 represents the adjusted net lease costs.

Table 3

LOS ANGELES COUNTY OCCUPANCY AND RENT

Fiscal Year
Occupancy
Rent
Rent/SF
1990 Rent
Adj for CPI
Variance
1990-91
4,985,249
43,348,034
\$8.70
\$8.70
\$0.00
1994-95
5,043,160
50,862,883
\$10.08
\$9.79
\$0.29

Source: ISD

Additionally, it should be also noted that during this same period, the County opted to utilize

leasing as a vehicle to fulfill its space requirements. A number of transactions consummated during this period were not typical market transactions, but specialized ones. These included several large build-to-suit and lease acquisitions which were achieved utilizing this mechanism. Examples of those include the DPSS' Headquarters (55,000 sq. ft.) and Rancho Dominguez (133,000 sq. ft.) facilities, Superior Court (125,000 sq. ft.) facility at 600 Commonwealth, and others.

As part of this study, ISD provided the Commission with detailed listings of all County leases for office space exceeding 20,000 sq. ft. The listing disclosed approximately 100 such leases over 20,000 sq. ft., with Children and Family Services, District Attorney, Health Services and Public Social Services having the majority of these leases. From the data provided, it is evident that the County has consistently followed a practice of leasing office space for departments whose occupancy costs are wholly or partially subvented by other governmental agencies.

For the most part, this practice is the result of an institutional bias created by the subvention programs of governmental agencies. In substance, greater cost recovery is achieved by the County under existing subvention formulas for costs associated with the rental of office space from the private sector, than is obtainable should these same programs be housed in County-owned facilities. As a result of this institutional "reimbursement formula bias", lease versus own decisions and broader asset management planning strategies and decisions to consolidate office space are made more problematic. In addition, since program existence and delivery levels are dictated by the subvening governmental agency, it becomes somewhat speculative for the County to address these needs other than by leasing space for the particular program. However, since leases are generally for terms of at least 10 years, the underlying program needs are generally believed to be long term in nature.

While the County may be unable to change specific subvention formulas, it is evident that greater utilization of block grant type funding from the subvening unit of government may obviate some of the problems caused to real estate management by the existing subvention structure.

The time and budget constraints inherent in this report did not allow for a complete review of all leases over 20,000 sq. ft. Rather, this analysis focused on a sample of 10 of the 100 leases which fall into this category. The sample leases were selected according to criteria which would insure that they were representative of the target population. Four subvented and six general funded leases were included in the sample population. They were selected, relative to commencement and expiration, by when they were entered into, the late 1980s and early 1990s. It is during this period that market rental rates for leased office space were trending down. As to location, leases were selected from each supervisorial district in an attempt to achieve geographical coverage of the County. As to rate, leases were selected which generally had the highest current per foot rates in each Supervisorial district.

While this last criteria would appear intuitively obvious to aid in detecting market variances, it

must be noted that high per square foot rates may disclose a lesser variance to market than a lower per square foot rental rate. This choice to review higher per square foot cost leases was based on an attempt to identify potentially larger savings. This theory cannot be statistically proven by the method used to select leases for review, and thus, must be considered to be random. Nevertheless, the leases reviewed sufficiently represent existing conditions to support the conclusions reached. Appendix D provides a list of the reviewed leases.

Once selected, copies of all leases and amendments, together with ISD's current rental payment calculations and authorization memoranda were provided by ISD. These leases were analyzed to separate, to the extent possible, the various components of the rental payments called for under the leases into several categories of payment. The County generally enters into what are typically referred to as "full service gross" office leases. In such forms of office leases, the Lessor obligates itself to provide not only undisturbed use and possession of the premises, but also all building services necessary for occupancy. This includes utilities, insurance, taxes, maintenance, repairs and replacements, parking, construction of the space to suit occupancy, etc.

In return, the Lessee obligates itself to pay a monthly rent which includes not only payment of the basic right to occupy, but also a number of other costs, such as specific improvements to the premises to respond to occupancy requirements (commonly referred to as "over standard improvements"), exclusive or non-exclusive parking rights, special building services, modular and other furnishings, fixtures, and equipment associated with the lessee's operations. In some cases, the subvention program involved will institutionally bias the County's negotiation of the terms of the lease. The lessor is occasionally asked to finance the acquisition of personal property necessary to the occupancy and the delivery of the program services. As a result, the rent includes the amortization of the cost of such personal property acquisition under the lease. Since not all of the monthly rental payments may necessarily relate to the pure cost of occupancy, it was essential to segregate these costs prior to attempting to compare the County's current rental costs to quotations for occupancy of comparable space in the current office rental market.

Once the current rental payments were segregated, by cost for occupancy, building operating expense, escalation of operating expenses, CPI adjustment, amortization of over-standard improvements, parking costs, amortization of other personal property acquisition costs and other special features, the market in the general location of each of the leases was examined for its general characteristics. A number of quotations were secured for comparable space and several sources of general market rental rate levels and ranges were reviewed. The object of this review was to identify the existence of any significant variances to the selected County leases.

Since the rental market for office space is imprecise and since each building has slightly different levels of quality and service to the lessee, it would be improper to view comparisons of rental

rates with great precision. Given the particular circumstances of a building owner, it is not unusual for an owner in difficult financial condition to deeply discount quoted occupancy costs to secure a tenant. Such aberrations can always be found in the market, but should not be assumed to represent a proper alternative to satisfying the space needs of the County. For the purpose of this review, the standard applied was a determination of whether the County was effectively working within the marketplace to satisfy its occupancy needs within a reasonable range of the market.

Market rental rates for full service gross leases are expressed in terms of a price per square foot, per month, which includes base rent and base operating expenses for completed building standard

premises. Current rental payments under the County's leases also include the cost of other items such as over-standard tenant improvements, parking, modular furniture amortization, etc. For a valid comparison the costs for the ten leases selected calculated the current effective cost of occupancy including only the items typically included in standard market pricing. The Table in Appendix D summarizes the stated contract rent and the "adjusted current rent" which factors out the over standard items that could be identified as being included in the lease.

Several markets have shown significant declines in rental rates since the County entered into the leases under review. Based upon this information, it appears that the County has not kept pace with the market. However, it is possible that the leases under review were at market rate when entered into, with annual CPI increases resulting in a widening gap between contract rent and market rates under rapidly deteriorating real estate market conditions. The County may not have been in a position to take advantage of this market decline, since improvements may have been made that would be expensive or impractical to duplicate or relocate. The cost of relocation may offset some or all of the benefits of reduced rental rates.

The example below uses the following assumptions:

a. that the County signed a ten year lease in 1990 for 50,000 square feet of space, at a cost of \$1.90 per square foot.

b. the lease is five years into the term and is cancelable at the option of the County upon payment to the Lessor of unamortized costs which are the responsibility of the County under the existing lease.

c. the \$1.90, amortization of over-standard tenant improvements to the building and modular furniture costs account for \$0.30 per square foot, leaving a base occupancy cost (full service gross) of \$1.60.

d. that similar office space could be obtained in the market for \$1.25 per square foot.

Based on these assumptions, resetting the lease to market would appear to save the County \$0.35 per square foot per month on 50,000 square feet for the remaining five years of the term of the lease, or \$1,050,000 in nominal dollars. This conclusion, however, does not consider the "exit" costs built into the terms of the lease. In this example, unamortized improvements costs of approximately \$900,000 would accrue to the landlord upon cancellation. In addition, the County

would incur the costs of physically relocating the program housed in the leased space, as well as those costs to duplicate the special program requirements in the new space. Costs could also be associated with the service disruption of the affected department.

The above example does not mean to imply that it is not possible to take advantage of market opportunities as they arise, but rather that such a review must be undertaken on a net present value basis, considering both real estate and non-real estate costs. The CAO should develop policies and procedures to continually review the market situation with respect to its occupancies.

With this information it may be possible to exercise options such as, early cancellation provisions

in existing leases, renegotiation of rents where opportunities present themselves, and relocation of activities where economically beneficial after taking into account all of the costs and benefits associated with relocation. Intrinsic in the long term facility decisions on existing leases is the necessity for less fragmented and more comprehensive strategic facility planning by the County. Keeping pace with the rental market is one of the many interrelated goals of a well-managed and controlled facility program.

#### Recommendations

15. Direct the CAO to implement the concept of rent charge back.

Implementation: Within six months

16. Direct the CAO to review all lease and concession agreements for adjustment to market lease rates. Priority for this review should be based on upcoming contract cancellation or expiration dates.

Implementation: Initial review within six months, and ongoing thereafter.

17. Direct the CAO to develop policies and procedures to review the rental market relative to County occupancies with the objective of exercising early cancellation provisions in existing leases, renegotiating rents and relocating activities.

Implementation: Within twelve months

18. Direct the CAO to meet with Federal, State and municipal representatives to discuss shared government facilities and possible consolidation.

Implementation: Within three months

19. Direct the CAO to determine whether including facility maintenance costs within leases is cost effective.

Implementation: Immediately

#### Strategies for Owned Assets

County-owned assets include land and a wide range of building types, from service sheds in maintenance yards to large administrative buildings, such as the Hall of Administration, in downtown Los Angeles. Owned assets include both those that are free of debt and those that are subject to financing.

In the context of the total County portfolio, owned assets comprise 88 percent of the total area and 60 percent of the total assets, indicating that the County tends to own, rather than lease, the facilities which house its largest occupancies. Of the owned assets, financed assets account for 45 percent of the owned assets by area and only 12 percent of the number of assets.

The County has used its largest and most significant real estate assets to raise funds through the issuance of debt. Among the significant County facilities subject to financing are the Hahn Hall of Administration, a number of municipal courts, the Central Jail and its various additions, County-USC Medical Center, the County Courthouse, the Criminal Courts Building, Olive View Main Hospital, Sheriff's Headquarters, the Downey Administrative Building, and the Public Works Building,

The wisdom of using real estate assets to secure financing has been raised during the budget discussions. A number of assets have used debt to fund acquisition or construction. Examples include the Public Works Building, which was the acquisition of an existing building, and the construction of the new addition to the Central Jail. Use of debt for purchase and construction has, in the past, been a part of accepted asset management practice.

It is evident from the information provided that capital raised from real estate financing has been used for the acquisition and improvement of these real property assets, as well as for non-capital purposes. Using the proceeds from financing for operational purposes is a highly risky strategy

which can jeopardize an effective asset management plan, the integrity of the real estate portfolio, and the County's credit rating. The amount of financing achieved is, in part, a function of the lease rates paid. In a declining real estate market, the County cannot take advantage of the decrease in rental rates, since it must remain in the leased facilities at the rates stipulated in the lease in order to maintain the conditions of its financing.

The integrity of the real estate portfolio may be damaged when assets are over leveraged. The ownership of real estate carries with it certain responsibilities to maintain the investment in good condition. The average age of the County's owned office and warehouse/industrial assets is approximately twenty nine years. Several of these facilities have extensive deferred maintenance that compromises both their market value as well as their working environment. In addition to deferred maintenance, there are increasing regulations in the real estate industry that may require the expenditure for this purpose. Two recent examples include the requirement to remedy hazardous material contamination, ie. removal of asbestos and the remediation of contaminated soil, and the Americans with Disabilities Act (ADA), which has resulted in the retrofit of existing buildings to accommodate access.

Owned assets can be a powerful tool for both revenue enhancement and cost reduction. Appendix

C demonstrates a methodology by which owned asset can be considered in the context of potential strategies and constraints to determine a rationale strategic deployment. The principles guiding efficient use of owned assets can be summarized as follows:

- \* Continually monitor markets to understand the value of owned assets and to identify unique opportunities

The fundamental principle of asset management, even within government, is to increase the return

on invested capital. This return cannot be measured without understanding the value of both the entire portfolio as well as the individual assets. Market monitoring will help the County make reasonable decisions about whether additional capital investment in an owned asset makes economic sense, and whether there are other occupancy alternatives which would make better economic sense. For example, the County owns several buildings in the vicinity of the 500 block

of South Vermont. This area is experiencing a deep decline in real estate values, and many buildings are available for purchase or lease at very low rates. The County should consider the consolidation of its many fragmented occupancies in the area. Market information should be used

to determine whether it is more cost effective to upgrade existing facilities or purchase an existing building to accommodate the consolidated occupancy.

- \*Maximize the physical use of each asset

As an owner/user, the County should seek to house as many of its departments as possible in owned facilities. An exception to this would be a departments that receives rent subvention from Federal and State-funded grants. Based upon current program requirements, these occupancies should be housed in leased facilities where occupancy costs are funded through non-County sources.

As discussed several places in this report, consolidation of occupancies offers the County a large potential for cost savings. Consolidation should consider reasonable estimates of future growth in order to improve long-term effectiveness, as well as capitalizing on the potential synergies between various County and non-County occupancies. For example, many visitors to DPSS district offices may also be clients of DCFS. Co-location of these functions could reduce the amount of space required in separate occupancies and would provide greater convenience to clients. Similar synergies may exist between County and non-County agencies. The potential to co-locate with other jurisdictions should also be explored.

\* Carefully monitor occupancy and operating costs to look for efficiencies

The County should continually seek ways to improve its operating cost effectiveness in owned facilities. Bench marking performance against private sector results should be done regularly to insure that performance is optimized. Where appropriate, capital investment should be considered to offset operating expenses. For example, much of the County's on-site security is currently provided by patrol. The installation of alternative security systems, such as card reading systems and/or camera monitors, may reduce or eliminate the need for patrols during certain hours. The capital costs should be considered compared to the potential savings, and a "payback period" should be calculated. In addition, the County must use the size of its portfolio to leverage service contracts and make sure that operating costs are minimized. Service contract price and performance should be monitored regularly to insure that the County is receiving full value

\* Make sure that realistic capital budgets are developed and carefully implemented

Real estate assets require continued funding to maintain the value of the portfolio. However, these expenditures should be made only when it makes economic sense relative to the market value of the individual asset. Market conditions should be continually monitored to insure the appropriate level of capital expenditure. Similarly, debt should be used in those instances where it is appropriate to maintain the value and integrity of owned assets. Leveraging assets for non-capital expenditures will severely limit the ability to properly maintain real estate assets.

## X. IMPLEMENTATION ELEMENT

## Chart IV

### Implementation Element

Implementation of an integrated asset management strategy requires an organizational structure and operating environment that will create the maximum

level of opportunity for success. Although additional study will be required to fully describe the organizational structure and operating procedures required to achieve the objectives outlined in this report, there are certain characteristics of a successful public real estate organization which can serve as guiding principles.

As with all organizations, the new asset management function will require a clearly defined organizational mission before the program can be implemented. The mission that has been proposed in this report serves as basis for establishing the overall goals and objectives; establishing a set of working procedures that will be used to achieve these objectives; a schedule for putting procedures to work in reviewing results; a method for measuring progress against the objectives, and a system of rewards for "stakeholders" who help to achieve success

The working procedures used to achieve the goals and objectives of such an organization should be defined by the individuals who will be directly responsible for putting them into place. It is important that the procedures be the goal, rather than a specific task. This orientation allows for maximum organizational flexibility to accomplish the objectives. It is clear to all that the real estate industry is highly entrepreneurial and market conditions can change quickly. Given this environment a procedural approach that does not provide this flexibility to asset management will almost certainly fail. Procedures defined by goals will insure that the organization remains competitive in this entrepreneurial environment.

Measuring progress against the objectives will be one of the most important elements in the implementation process. Discussed in more detail below, the initial step in the measurement process is the establishment of current occupancy costs. This will establish the baseline against which future results can be measured. The preparation of a comprehensive occupancy cost analysis will be a useful tool for all future discussions of real estate asset management.

Implementation of an asset management program will require an organizational structure that supports successful operations. One of the most important characteristics of this organization is the empowerment to act. As an asset class, real estate is a very significant element on the County's balance sheet. The asset management function must be highly placed within the County's organizational structure in order to achieve its far reaching objectives and the access needed to get

decisions made in a timely manner. The centralization of the asset management function in the CAO's office should be able to achieve this level of empowerment. The organization requires a level of autonomy to act in the best interests of the County as a whole, rather than the interest of individual departments or other "clients". The individual departments should have the ability to specify their real estate needs. An entrepreneurial asset management organization will question both the department's assumptions and its assumptions concerning rules and policies, to insure that the County maximizes the value of its portfolio.

Accountability is another important characteristic of asset management implementation. Results will be measured against the established goals and objectives, and the asset managers will be responsible for achieving those objectives. The asset management function as described in this report is accountable to the CAO, the Board of Supervisors, and ultimately the citizens of the County.

Finally, asset management cannot be successfully implemented without entrepreneurial leadership. A successful leader will be focused on the future and the potential of the portfolio, rather than on the status quo. A sense of ownership and a bottom line orientation will create an environment where rules and policies can be challenged and reasonable risk-taking encouraged.

## Recommendations

20. Direct the CAO to appoint a Head of Asset Management who will be responsible for implementation of the Asset Management Program.

Implementation: Immediately

## XI. MANAGEMENT ELEMENT

### Chart V

#### Management Element

Studies within the field of asset management continue to indicate that the proper management of real estate assets by an organization can make a significant positive short-term, as well as long-term, impact. Senior management assumes the role of landlord, casting the central real estate group as a property manager with the use of appropriate performance based incentives. Individual Departments then negotiate with the real estate unit.

Cost control is one of the strongest motivations for a hands on approach to the management of the

County's real estate. Real estate asset management does not end with the acquisition of real property by lease or purchase. Continuing problems are to allocate space to the most profitable uses within the County, to monitor expenses, to maintain control, to identify property that is underutilized by the County and to redeploy underutilized or surplus assets. The real estate activities of the County increase with the growth of programs or activities or with an increase in the geographical requirements to provide services.

Without the cost allocation ("charge back") of market based rent to a departmental user of the space, there will be a problem with the efficient allocation of space within the County. Indicators of surplus property are square feet per employee or land per building. Identification of undervalued space, however requires imagination, knowledge of current real estate markets, and alertness to decisions about real estate being considered by the County.

Recommendation:

21. Direct the CAO to establish a systematic preventive maintenance program to avoid the accumulation of long-term maintenance costs and to recommend a plan to finance such maintenance.

Implementation: Within three months

22. Direct the CAO and department heads to identify specific funds for real property maintenance, and to restrict the use of those funds.

Implementation: Through the Budget Process

## XII. MONITORING ELEMENT

### Chart VI

#### Monitoring Element

Monitoring performance is a critical step in the asset management process. The monitoring function must be performed at both the portfolio and asset levels in order to be effective. Results must then be benchmarked against performance in other sectors, and strategic adjustments determined as necessary.

At the portfolio level, the County's asset performance should be measured against three components:

return on investment, space utilization, and improvement from status quo. Return on investment (ROI) is a standard portfolio measurement technique used by private sector investors to insure that real estate dollars are earning a return commensurate with the riskiness of the investment. As an

owner/occupant the County is less concerned with risk and more concerned with capital allocation.

The ROI measurement will help the County prioritize decisions about whether to acquire or dispose of assets; build, buy, renovate, or lease; and how to properly capitalize its real estate asset base.

Space utilization is a measurement that is most commonly used by corporate owner/occupants to insure that all owned real estate is being properly utilized. For example, the private sector space utilization for office occupancies is at approximately 200 square feet per occupant, and falling. Although no information is available at this time for County occupancy, it is not uncommon to find public sector space utilization at 300 square feet per occupant. Development of space standards and other programming and space planning techniques, can greatly increase the efficiency of the space utilization, and the cost to implement is usually paid back in cost savings in a very short period of time.

The objective of monitoring asset management accomplishments is to determine that progress that has been made from status quo. This assumes that the County begins its asset management program with an accurate picture of current real estate utilization. The County should act quickly to establish a baseline occupancy cost measurement in order to gauge the cost effectiveness of an asset management program. This baseline should be updated annually in order to encourage creativity and continued improvement. This annual update will serve not only to measure progress against objectives, but also to reestablish new goals and objectives and encourage creative problem solving.

At the asset level there are several basic monitoring activities that must be undertaken. Leased properties should be part of a regular market monitoring program which actively seeks opportunities for lease rate savings and innovative approaches to lease term structuring. Leased properties should also undergo periodic audits of operating expense billings. Pass through expenses and base year operating costs are often incorrectly calculated by landlords, and the increased costs can be compounded in the future years. Periodic auditing of these expenses eliminates over billing and in some cases can result in rebates for prior over billing.

Monitoring for owned properties should include market values of individual assets and operating costs. Periodic review of the fair market value of owned assets will help the County make informed decisions about acquisition, disposition, and capital investments. Operating cost reviews will

establish cost effective property management principles and allow the County to maximize the use of its portfolio leverage to achieve cost savings.

Both asset performance and portfolio performance should be regularly compared to similar results in the private sector. Strategies should be reconsidered and adjusted in areas where results lag other sectors. Creative strategies, including the possibility of privatizing some activities, should be considered for those areas where performance is chronically below other sector results.

If property is leased, renewals should be monitored to determine the best time to negotiate for renewals or to possibly take up options to buy. Whether property is purchased or leased, the utilization of space should be monitored to determine the over- or underutilization of the property.

If the space has not been fully utilized, or if other circumstances have imposed themselves making the continuance of occupancy undesirable, the County may have a property that is proving to be a drag on the County's resources.

If space is crowded, costs of operations may increase. Renovation and expansion of that space or additional space may be needed to obtain a more efficiently conducted operation. If the property increases in value because of changes in the surrounding areas, the County may be utilizing space that is too expensive for its needs. It may be better to sell or sublease the space to move to more economical space for a specific operation.

#### Recommendation

23. Direct the CAO to develop a methodology to monitor performance of County real estate.

Implementation: Within three months

24. Direct the Economy and Efficiency Commission to meet with the CAO, and any other agencies or departments, as appropriate, to assist in implementing the asset management program and to report back to the Board quarterly. The first quarterly report should establish a project management timeline for implementing the strategic asset management program.

Implementation: Quarterly

### Revision Element

Monitoring results will lead to an identification of strategic needs and to actions that can be taken in the present to capitalize on revenue or cost savings opportunities. Where performance does not meet objectives, both the strategy and goals should be reexamined. As with all on-going programs, asset management will require periodic "retuning" to stay in step with new developments within the real estate industry and local markets.

An important goal of revision is to understand the critical legislation, policies, and practices which can limit strategic deployment or tactical action. Where practical, key legislation and policies should be challenged and changes proposed. There are several examples of this presently underway. Current state law provides that County-owned assets may only be leased at auction to the highest bidder. This cumbersome process is generally not taken seriously by the local real estate market. Thus, the County is placed at a disadvantage compared to other potential landlords. The CAO is currently working on proposed changes to this legislation that would allow the County to be more entrepreneurial in leasing properties.

Almost as restrictive as legislation and policy are common asset management practices. This attitude of "we've always done it this way" often limits potential for cost savings and revenue enhancement. Common practice constraints are easy to resolve once they are identified, and often yield meaningful results in the short term. The County has recently made some progress in this area, leasing retail space on its Mall to a private sector food service operator with the result of increasing revenue to the County and providing a better environment for the citizens of Los Angeles County.

### Recommendations

25. Direct the CAO to identify changes, modifications or additions to Federal, State and local legislation and/or policies necessary to enable a business-like disposition of surplus assets. For example, the requirement that surplus property must be leased at auction to the highest bidder.

Implementation: Ongoing part of the County's legislative program.

## XIV. FUTURE STRATEGIC DIRECTION

The real estate markets in Southern California experienced a significant downturn during the late 80s and early 90s. This situation is reflected in a higher vacancy rates, little construction of new product and softening rental rates and acquisition costs. Given this environment, it can not be assumed that strategies favoring a large scale disposition of County assets are appropriate. Serious consideration must be given to alternative strategies in which the County works proactively to reduce its occupancy costs. For example, consolidation of facilities and renegotiation of rental rates in leased properties may prove to be both effective and rewarding. Currently, situations exist within Los Angeles County of two or more governmental agencies or functions residing in either the same building or in close proximity to each other. The fact that there is no mechanism for evaluating these possibilities demonstrates the failures of the current process to evaluate alternatives for governmental occupancy.

Consolidation and cooperation are important concepts to be addressed over the next several years.

Expanding upon these concepts requires that the County develop a mechanism by which these, and other potential innovative approaches, can be effectively analyzed and implemented. This mechanism will require action on the issues raised in this report, ie. the implementation of an information system that will provide an accurate inventory.

A number of governmental agencies are struggling with these same problems. Specifically, the City of Los Angeles has contracted to develop an extensive and detailed inventory of its property holdings. With this inventory the City hopes to establish a coherent Office Facilities Strategy and to be in a position to improve service to constituents, reduce costs and capitalize on revenue generating possibilities.

This project offers Los Angeles County a unique opportunity to take advantage of the efforts of the City in developing its future approach to this problem. Understanding the problems and the successes encountered by the City by initiating and coordinating efforts, the County will be able to capitalize upon and learn from the experience at a significantly reduced cost. This approach also offers the County the opportunity to structure the development of its asset inventory to be consistent with that of the City, in anticipation of maximizing future asset management opportunities. The advantages to this approach are numerous; improving the possibilities for future intergovernmental

coordination, the possibility of learning from the experience of a comparable governmental organization that is attempting to solve the same structural problem, little or no cost that would be incurred as a result of this approach, the possibility of increased utilization of both County and City property, the possibility for both reduced costs and increased revenues, the increased possibility to capitalize on future opportunities in the development of County real assets, the economic and social gains to the community in having the assets of governmental effectively managed and the recognition to be gained by credit agencies and the community that the County is attempting to addressing these issues, in an efficient, cooperative and cost effective manner.

The County should begin by attempting to run its asset management system parallel to that of the City, with some lag time to insure that the problems identified by the City can be corrected prior to being duplicated by the County. This approach, in addition to the advantages identified above, would enable both the County and the City to recognize the concerns of other governmental agencies, ie. federal, state, special districts, school districts, MTA, etc, in any future cooperation and consolidation efforts. Developing the management philosophy that facilitates consolidation and coordination brings the governmental and quasi-governmental agencies closer together in addressing their common asset management problems, thus, further capitalizing upon the advantages that have been identified above.

Prior to proposing this approach the Commission held conversations with Mr. Daniel Rosenfeld, Assistant General Manager, Asset Management Division, City of Los Angeles, to establish whether it would be acceptable from the City's standpoint. In a memo to the Commission, Mr. Rosenfeld expressed support for the pursuit of this matter. In this memo Mr. Rosenfeld states that the County and City in exploring these possibilities could "...make efforts over the next three years to standardize their policies and procedures including the following:

- A. Space Inventory Software
- B. Space Utilization Standards
- C. Facilities Plans
- D. Lease Forms and Leasing Policies
- E. Design Specifications
- F. Maintenance Specifications
- G. Property Management Accounting Software
- H. "Charge back" Procedures for Government Tenants."

The future direction of this approach may include the establishment of a governmental or quasi-

governmental agency to assist in coordinating and facilitating the use of governmental space. This organizational approach is currently being pursued on a smaller scale by the intergovernmental cooperation in the development of the downtown center. The success of this effort will service as a test bed for the concepts being proposed.

The real advantage to pursuing this direction is that it does not require any additional expenditures by the County to pursue, while enabling the potential for a significant level of savings and revenue generation. Bringing governmental agencies together may well prove to be a critical and required element to "reinventing" government. It might also prove to be the case, as is presented in Appendix E that other approaches may follow as a result of the experiences gained in achieving the program based upon coordination and cooperation being proposed. For example, the State of Colorado has adopted a "all private sector" leasing approach to solving their office requirements. Colorado "contracted out" the leasing division of Colorado's General Services Department. Using this approach the State's space requirements were projected to decrease by 15-20% due to increased efficiency. When savings in rental rates and operating cost pass-through's were added, total savings were anticipated to be in excess of 20%.

A more unusual approach was that taken by British Columbia. The Province created the British Columbia Building Corporation (BCBC). The purpose of this corporation is to provide office and certain other real property needs for the Province's various governmental activities. By law the BCBC is required to charge market rates for all leases and services to governmental agencies. The net revenues generated are split between the General Fund of the Province and a reserve maintained by BCBC to fund the equity required for future projects. This approach has resulted in a significant increase in the efficiency of real estate activities for the governmental agencies of British Columbia.

The preceding discussion illustrates that asset management function of Los Angeles County should commit a great deal of thought to the future direction of the County's Asset Management Program and to the approaches needed to achieve the objectives that this program should establish. The County must recognize that whether or not effective action is taken, or as in the past not taken, either course will provide the basis for the County's transition into the next century.

It is clear that the current approach being used by the County has become outdated, even to the point at which the current plans are to be implemented. If the ideas and concepts that have been raised by other managers in the field of asset management throughout the world are not seriously considered in the development of an effective asset management program, the County will not be able to develop an effective program and will sacrifice the potential for achieving savings and generate revenue that would result from the efficient use of real asset resources. Regardless of the strategy pursued, the County must conceptualize, adopt and follow a future oriented position in developing its strategic plan development. This mind set must consider radical new ways of approaching the problems that are currently faced by the County in managing its real assets.

#### Recommendation

26. Direct the CAO to incorporate within the Strategic Asset Management Plan the concepts of intergovernmental coordination and cooperation.

Implementation: Within one year

#### XV. CONCLUSION

Historically, the Economy and Efficiency Commission's position has been to develop a formal policy intended to guide the County's real estate management and development activities. The recommendations of the EEC have focused on the establishment of an economic based asset management system with a formal policy statement, including objectives and a monitoring system.

An initial inventory of County properties is to be improved and centralized. A key component of these recommendations is the initiation of a market-based "charge back" system for internal rent and leasing of County space. Department heads are to be given incentives to improve performance of their real estate assets.

The focus of this study has been to segment the real estate holdings of the County in a manner that would reflect real estate market analysis. Once segmented in this way, a wide range of strategic alternatives were considered according to the type of property and its ownership status. The purpose of this analysis was to generate the maximum number of opportunities for revenue enhancement and cost reduction. After all strategies were analyzed, potential constraints associated with the various

approaches were considered. This sequence provided the maximum creativity in the development of strategic options, prior to considering the legal and policy constraints. Where necessary, needed changes in policies and regulations were considered as part of the overall asset management recommendations.

This effort recognizes that similar studies have been conducted in the past, with little action taken by the Board. However, the approach taken by this study is different from past efforts. Rather than concentrate on the use of County assets in the context of County operations, it considers the potential of these assets from the perspective of real estate markets. It attempts to identify the potential revenue generation and/or cost reduction impact of each of the recommendations, in order to provide the Board with a sense of the priority for each.

The recommendations provided in this report form only the beginning of an effective asset management program. As the recommendations are implemented, the Economy and Efficiency Commission hopes to take an active role in measuring the effectiveness of the strategy. Specific "success standards" should be established for each major component of the asset management strategy, and periodic review of results against these standards should be conducted.

This report has considered a number of subjects related to the current management of real property and of office facilities of the County of Los Angeles. Given the importance of real estate, both in the delivery and cost, the Commission continues in its position that it should be given a continuing priority. Based upon the information discussed herein, it is apparent that a great deal more thought and discussion must be committed to further changes in organizational structure, to the development of new policies and procedures focused on improving results and to changes in legislation necessary for the results to be achieved. □

## APPENDIX B

### CITY OF LOS ANGELES ASSET MANAGEMENT POLICY

WHEREAS, the City of Los Angeles owns and leases real property worth billions of dollars used for diverse necessary public purposes, such as office buildings, police stations, fire stations, libraries, public parks, open space, roads and maintenance facilities; and

WHEREAS, the City's real estate needs and the satisfaction of those needs, whether by redeployment of existing City property, acquisition or construction, requires thoughtful strategic planning and the coordinated efforts of all departments; and

WHEREAS, it is in the public interest for the City to manage its real estate under a clear and consistent policy direction and a coordinated central administrative process to obtain the best utilization of this real estate and to identify property that is vacant, unused, underused or inefficiently used,

NOW, THEREFORE, WE, RICHARD RIORDAN, Mayor and the Council of the City of Los Angeles, by virtue of the power and authority vested in us by the Los Angeles City Charter and statutes of the State of California, do hereby issue this order to become effective immediately:

- A. It is the policy of the City of Los Angeles to achieve the comprehensive planned management of the City's diverse portfolio of real estate to ensure optimum use for the City's operations and maximum value from the excess.
- B. In the planning and implementation of this policy the following six principles shall be applied:
  1. Inventory:

The City shall create a Strategic Property Inventory of all City-owned and leased real property assets as the central real estate management system of the City.
  2. Cooperate:

The City shall create an Asset Management Group within the Department of General Services to implement this policy and to provide recommendations to the Mayor and City Council on City-wide real estate management issues. All City departments shall cooperate with the Asset Management Group in the implementation of this policy.
  3. Plan:

The City shall develop a comprehensive twenty-year master plan of facilities needs and shall update this plan every five years to maintain a continuous twenty-year facilities needs projection.

4. Consolidate:

The City shall, where feasible, consolidate its operations into joint-use facilities at those locations where several departments with reasonably similar and compatible real estate or facility needs are serving a similar geographical area or where geographic service is not a factor.

5. Finance:

The City shall, where feasible, seek long-term contracts, either ownership or extended leases, where the need for the facility is long-term and where a long-term contract is economically advantageous over the life of the facility. In addition, the City shall annually review the capitalization of its owned and leased properties to identify refinancing or lease renegotiation opportunities.

6. Manage:

The City shall maintain strategic asset management staff and shall, where feasible, cooperate and develop projects jointly with the private sector and shall seek new opportunities for the involvement of the private sector in accomplishing the real estate activities of the City. □

## APPENDIX E

### ASSET MANAGEMENT IN OTHER GOVERNMENTS

#### Introduction

During the 1980's, corporate America tended to its balance sheet with particular attention to low cost basis, soaring real estate value. While this increased focus on asset management was occurring in the private sector, there was substantial growth in the governmental work force, especially in California, with increasing real estate needs met with fragmented and reactive solutions. In the mid-1980's, many governmental entities, including the County of Los Angeles, began to address the issues surrounding the satisfaction of the governmental real estate need and the management of public real estate.

Most of government lives in a world of "pay as you go" budgeting, where capital projects are considered more in light of available current funding than in view of the longer term net benefit of the capital investment. In addition, the management of any real estate program requires a multitude of subjective judgments. Often, there are multiple correct answers available to solve any particular facility problem or real estate situation.

Successful real estate management requires creative and simultaneously processed activities by people and organizations who can overcome false starts and failures along the way. Agreement on the mission and consistent progress toward the goal by individuals who can lead others, and adapt to changed facts and lessons learned, are required to achieve desired results. As a result, superior real estate management in our democratic form of government is, in many fundamental respects, a difficult governmental activity to achieve. Success is often the product of individual leadership capable of achieving the trust and confidence of elected officials. The person who achieves this leadership is then in a position to earn the acceptance of the subjective decisions of those managers on the multiplicity of correct answers to any particular problem.

It is particularly striking to review the reports and recommendations on the subject of County Real Property Management made by the Economy and Efficiency Commission in December, 1986 and

August, 1991, and the Quality and Productivity Commission Report of 1993. These studies evidence a continuing theme of the need for: 1. a usable inventory, 2. centralized leadership and accountability and 3. reform of the state laws and other legislative mandates in order to achieve the effective management of the County's real estate program.

#### State of California

It should be noted that similar situations exist with respect to real property management in other governmental entities. The State of California's Little Hoover Commission has regularly, since the mid-80's, reviewed the question of the State's management of its real property with findings consistent with those of the County.

Until 1991, the State of California did not have a usable centralized inventory of its real estate. The State was operating with 39 departments of State government having jurisdiction over real property. They maintained some level of inventory information, but there was no uniformity of information, nor centralized system, to determine the State's real property ownership and leasing activities. To find the location of State property in Los Angeles, for example, managers had to rely on the Los Angeles local telephone book or to request the information from each of the 39 departments.

While the State still lacks complete managerial control of its real property, it has made substantial progress in real property management since the completion of the Statewide Property Inventory. This database has permitted the inquiry into the existing condition of the portfolio in an intelligent manner by the State Department of General Services and other state departments and elected officials. The development of this portfolio review capability has generally followed a geographically based strategic planning process. This undertaking has been conducted with the assistance of private consultants to review the State's real property needs in a defined area, to develop a prioritized series of actions, to move the portfolio toward solutions and to permit a project based team to implement the defined goals with the benefit of legislative approval.

Policy guidance in the area of asset management at the State level is found in Executive Order No. D-77-89 issued by Governor George Deukmejian and Executive Order W-18-91 issued by Governor Pete Wilson. In Governor Wilson's Executive Order, the State defines asset management as:

"The comprehensive planned management of the State's diverse portfolio of real estate to assure optimum use for the States's operations and maximum value from the excess." This definition

requires that the real property of the State must be managed in a comprehensive, planned manner with a focus on matching the real estate of the State to the delivery of program services by the State.

Real estate solutions must be focused on homogeneous property types in an acknowledgment that

the diversity of the real estate precludes singular solutions to all real estate problems. Only after assurance is achieved that the program needs of the State, i.e., not just a single department, are satisfied in a geographic area, should property be considered as excess to the needs of the State. Once determined excess, it is in the province of the elected officials to determine the disposition policy for that property or property type, which could include maximizing revenue to the State through asset development or satisfying some other policy priority such as open space, rededication

for other public use, etc.

Governor Wilson's Executive Order also created an Asset Management Coordinating Council within

the Executive Branch of state government. The Council's duties are to serve as a single point of contact for the coordination of the State's real estate portfolio. Without the inventory, such activity

is impaired, if not impossible. It is historically significant to note that a recommendation to set up

a similar body in the County was made by the Economy and Efficiency Commission in its 1991 report on real estate management.

## State of Colorado

The State of Colorado has adopted an essentially "all private sector" leasing approach to the satisfaction of its office needs. To the extent office space is required in the delivery of governmental

services, private sector real estate firms are engaged to provide the solution. A Request for Proposal

(RFP) was issued to secure a private firm to act as the State's leasing representative. A firm was selected to perform the function during a three year contract period. This solution is essentially the

"contracting out" of the leasing division of Colorado's General Services Department.

While the State of Colorado was a major user of leased office space in the Denver metropolitan area,

individual landlords did not recognize the State as a major tenant. The State had 96 small, short-term leases in the Denver Central Business District, totaling approximately 807,000 square feet and

averaging 8,400 square feet. Office facilities varied in condition from recently renovated to hazardous. Operating expenses also varied widely, with few provisions for renewal or expansion.

A study was prepared recommending a strategy to consolidate the many small leases into several

large ones, by zones. The strategy would lock in low rental rates, would create minimal disruption to operations and required no additional capital to implement. The State's space requirements were projected to decrease by 15-20% due to enhanced efficiency. When savings in rental rates and operating cost pass-through's were added, total savings were anticipated in excess of 20%.

## Federal Government

At the federal level, as product of Vice President Gore's National Performance Review, there has been significant debate on the issue of real estate management by the US General Services Administration. The problems of GSA mirror the problems of the County and the State in that its organizational structure was historically built on process, rather than focused on result. Responsibility for various activities in the real estate area are fragmented. Accountability is impossible to isolate. One of the reforms to come from the National Performance Review has been a modest reorganization within GSA with the inclusion of the newly created position of Portfolio Manager. The essence of the function acknowledges a need for geographically focused management of the myriad of real estate activities occurring within the federal government at any particular time. Time will tell whether this organizational adjustment will produce the desired improvements.

## International

### AUSTRALIA

The real property of Australia is under the management of Australian Estate Management (AEM), the equivalent of the US General Services Administration. AEM has been in a process of transformation since July, 1987 with a mandate to set in motion a "fundamental reappraisal of the provision of common services to government agencies," premised on the question "Can government afford government?"

Australia' experience has been carefully examined in the National Performance Review and many of the concepts employed in Australia are under discussion in the United States. Which, if any, will be adopted remains unknown. In summary, the reforms of Australian real property management have been based on the following shifts in policy and attitude:

### Chart I Australian Real Estate Management

## The Main Changes

FROM:

TO:

Centralized regulation of common services  
Supply of services geared to customer choice

Budget funding appropriated to AEM  
Trust Account funding based on fees for service

Cash accounting  
Accrual accounting and full cost measurement

Tied customers  
Untied customers

Inward looking, process-driven supply of services  
Outward-looking, customer focused supply of services

Performance judged by input costs  
Performance judged by results

While each of these changes is important to the overall improvements made, the two most noteworthy are the decision to have AEM compete for the business of other government agencies ("untied customers") and the measurement of performance based on results, rather than cost. Suffice it to say that a complete transformation of the attitudes of managerial responsibility has been attempted, with what is reported to be some success.

## CANADA - BRITISH COLUMBIA

In 1976, the Province of British Columbia created a Crown Corporation (essentially a public corporation owned by the Province) called British Columbia Building Corporation ("BCBC"). The Corporation is chartered to provide office and certain other real property needs of the Province's

various governmental activities. BCBC is governed by a Board of Directors of 9 public members, which Board appoints a Chief Executive Officer to manage the organization. By custom, but not by Charter, the CEO also has been appointed to a Board seat.

By law, BCBC is required to charge market rates for all leases and services to governmental agencies. It provides a full range of real estate services, including space planning and allocation, long-range planning, financial and needs analysis, leasing, construction development and management and routine property management. The net revenues generated through the efforts of BCBC are split between the General Fund of the Province and a reserve maintained by BCBC to fund the equity required for future development projects.

Through the centralization of property management functions and staff, BCBC has achieved greater efficiency in carrying out its responsibilities. Of note, in 1976, a total of 2,007 real property related staff and management positions were functionally consolidated into BCBC. By 1989, BCBC had only 799 authorized positions, and it has continued to control its staffing levels commensurate with its business levels and profitability.

□

APPENDIX D  
COUNTY OF LOS ANGELES  
LEASES REVIEWED

Department

Address

City

District

Lease No.

Rentable

Sq. Ft.

\$ Per Square Foot Per Month

Current  
Rent PSF 2  
Adjusted  
Current  
Rent 3  
Estimated  
Current  
Market

Children & Family Svcs  
5835 South Eastern Ave.

LA  
1  
66672  
38,814  
1.78  
1.47  
0.75-0.85

District Attorney  
2934 East Garvey Ave.  
West Covena  
1  
64318  
41,300  
1.52  
1.37  
1.00-1.20

Public Social Services  
12860 Crossroads Pkwy  
Industry  
1  
63808  
55,000  
1.89  
1.59  
1.20-1.30

Children & Family Svcs 1  
3160 West 6th Street  
LA

2  
62061  
40,892  
1.40  
1.21  
0.90-1.10

Children & Family Svcs 1  
695 South Vermont  
LA

2  
58575  
42,822  
1.27  
1.18  
0.90-1.10

District Attorney  
15531 Ventura Blvd.  
Sherman Oaks

3  
66261  
45,775  
1.79  
1.65  
1.60-1.70

Public Social Services 1  
14355 Roscoe Blvd.  
Panorama City

3  
60663  
23,500  
1.53  
1.27  
1.20-1.25

Health Services  
2525 Corporate Place  
Monterey Park

3  
62399  
29,542  
1.56  
1.43  
1.05-1.30

CAO  
12750 Center Court Drive  
Cerritos

4  
65676  
20,187  
1.54  
1.51  
1.50-1.65

Children & Family Svcs 1  
4060 Watson Plaza Drive

Lakewood

4

65889

71,450

1.57

1.45

1.25-1.30

Source: ISD for the lease information, Commercial Real Estate Brokers for the Estimated Current Market Value

1. Subvened Leases

2. Current Monthly Contract Rent Per Lease Agreement

3. Current Monthly Rent adjusted to eliminate any payments for over-standard tenant improvements, amortization of modular furniture purchases, and any other special charges not associated with general use and occupancy.

## APPENDIX F

### SOURCE DOCUMENTATION

The following asset management studies were reviewed as background material for this report:

Decision-Making and Organization in Los Angeles County Government, The Los Angeles County Economy and Efficiency Commission, June, 1983

Property Management in Los Angeles County Government, The Los Angeles County Economy and Efficiency Commission, December, 1986

The Role of the Chief Administrative Office and Asset Management in Los Angeles County, The Los Angeles County Economy and Efficiency Commission, December, 1988.

Real Property Management and Development in Los Angeles County, The Los Angeles County Economy and Efficiency Commission, August, 1991

The Los Angeles County Asset Management and Development Program, Planning for the Future, The Los Angeles County Quality and Productivity Commission and Chief Administrative Office, October, 1994

Real Property Management in California: Moving Beyond the Role of Caretaker, Commission on California State Government Organization & Efficiency (Little Hoover Commission), October, 1990

In addition to previous studies, the following source material was reviewed as background material for this report:

Review of the Proposed Restructuring of the Internal Services Department, The Los Angeles County Economy and Efficiency Commission, June, 1995

Performance Standards for the Lease Acquisition Process, prepared by Leasing and Space Management Division Construction and Real Property Service for the ISD Executive Committee, undated.

Asset Management Progress Report, Chief Administrative Office, March 3, 1995; March 31, 1995;

and May 30, 1995

Request for Work Plan and Cost Estimate to Develop GIS Database for County Real Property Holdings, Financial Management and Budget Operations to Internal Services Department, April 5, 1995

Disposition Strategies for County Real Estate Property, handout prepared by ISD, July 1995

Asset Development Projects, handout prepared by ISD, undated

County of Los Angeles Organization Chart, December, 1994 (Revised)

Memo from Local 660 SEIU AFL/CIO to Economy and Efficiency Commission, re: Los Angeles County Asset Management, July 24, 1995

Miscellaneous Real Property Holdings Inventory Lists, including inventories prepared by ISD, the Library Department, the Probation Department, the Fire Department, the County Development Commission