Managing Government Property Assets: International Experiences, edited by Olga Kaganova and James McKellar, is available from the Urban Institute Press (paper, 6" x 9", 448 pages, ISBN 978-0-87766-730-8, $32.50).

Chapter One
Introduction

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Governments own a vast array of real property—from large stretches of settled and unsettled land to public housing projects, from water distribution systems and roads to office buildings, and from infrastructure facilities designed to support the daily delivery of basic services to strategic parcels viewed as cornerstones in the revival of old central cities or building blocks in the economic development of entire regions. Typically, management of public property is highly fragmented with each category falling within a different jurisdiction or bureaucracy, or even with different policies and procedures within a given bureaucracy. In almost all countries, different classes of property, and even individual real property assets, are "managed" according to their own rules, often adhering to traditional practices rather than any assessment as to what type of property asset management was most appropriate. Over the last decade, however, a new discipline is emerging that looks more critically at this important component of public wealth and seeks to apply standards of economic efficiency and effective organizational management.

This book offers some review and analysis of this new wave of activity. Chapters draw upon a wide variety of national and local practice, both in countries that have been leaders in management reforms and in countries that are just beginning to wrestle with the problem of devising a coherent management strategy for real property assets. The issues of public property management, it turns out, are surprisingly similar in different countries, even though the institutional contexts and the attempted policy solutions often are strikingly different. This mix of similar problems but different strategies for addressing them provides the rationale for a comparative examination.

Focus and Objectives

Property asset management can be defined as the process of decisionmaking and implementation relating to the acquisition, use, and disposition of real property. This definition applies to both the private and public sectors, even though in the government sector, the term itself was not in common usage until recently. This book has two main objectives. The first objective is to introduce those governments that are only beginning to seek improvements in the management of publicly owned real property to the conceptual and practical experience of advanced reformers in the sphere of public property asset management. The second is to identify and analyze issues where the relative risks and benefits of the reforms implemented to date remain in doubt, thus setting the stage for the next cycle of monitoring, research, and practical experiments in real property asset management.

From a broad perspective, the task of a public property asset manager can be likened to that of a private organization holding a mixed portfolio of real properties, or to a mixed-use real estate investment trust. At one level, those in the organization must decide how to

manage individual property holdings—how to operate, market, and maintain them. At the next higher level, the organization seeks to identify common rules to guide and motivate its property managers so that the same guidelines regarding economic efficiency and other values are applied throughout the organization. Moving further up the organizational structure, decisions must be made about how to allocate capital across different classes of property—whether to liquidate holdings of one type of property, for example, and reinvest the proceeds in another class of property where the organization has a comparative advantage in management capacity or a legal mandate for coverage. Finally, such an organization must decide whether it will try to raise new financial capital to expand its investments in real property, or will sell property and return some of the proceeds to shareholders for their private use. Public asset managers make similar decisions regularly—though the process may be obscured by the many different institutions participating in decisionmaking and implementation. For many years in the 1990s, cities in the former Eastern European bloc, for example, sold off properties they no longer wished to hold or manage (such as restaurants and industrial factories) and redeployed the assets to finance a significant part of their infrastructure capital budgets consisting of water systems, wastewater treatment facilities, and road upgrading.

This book focuses primarily on the search for common rules, institutional arrangements, and management incentives to improve the efficiency and public usefulness of government-owned property. However, from time to time we step back to consider just why efficient management of public property assets is important, in the context of the broader issues facing governments today. Real property assets often are critical to financing government operations; they can collateralize borrowing; they are essential to public service delivery. Property assets like public parks and environmental reserves serve still other civic purposes. Public sector leaders must continually make choices regarding the type of assets that the public sector can most efficiently operate itself, those that can best be operated in partnerships of one kind or another with the private sector, and those that the public sector should exit altogether.

What this book cannot directly address is the political context for decisionmaking that inevitably affects how governments make the decisions that they do. Should they invest more in health care or renovate a portfolio of aging office buildings? To what use should they apply the proceeds of a sale? Political trade-offs will usually trump management decisions, but it is still the role of managers to make their political masters aware of the potential consequences of their ultimate choices. This is part of the job of efficient management and a task that highlights some of the differences between the manager of public assets and their counterparts in the private sector.

The very breadth of "public property assets" makes necessary some specialization of treatment. For the most part, we do not address directly the ownership or management of "public" housing, basic infrastructure facilities, or parkland not because these sectors are less important but because they raise particular issues that deserve (and often have received) targeted attention of their own. What is examined is mainly urban nonresidential real estate, including vacant land, owned by governments and their various authorities or entities.

One important caveat must be registered for a volume that attempts to share experiences with managing public property across international borders. Real property has to do with "rights" and the ability to bundle, alienate, transfer, and dispose of and otherwise control

rights of occupancy and use. Property, whether public or private, transcends mere physical attributes and is inextricably linked to culture and society. Real property has economic, social, spiritual, and political value, and those that deal with real property must understand these many dimensions and the opportunities and limitations that they represent. Countries associate property rights with issues of sovereignty. This book does not intend to challenge historic and well-founded beliefs. The Single European Act that amended the original Treaty of Rome consciously avoided any mention of property rights out of respect for the sovereignty of member countries. Article 222 of the act states that "this treaty shall in no way prejudice the rules in member states governing the system of property ownership" (Rydin 1990). There will be many situations where "solutions" cannot be shared across countries, as sound as they appear, simply because of the particular role that public property assumes in a given society or culture. In these cases, we hope that the principles embodied in a particular approach can be captured in ways that are acceptable to local norms of property ownership and use, or, at the least, that the experience of another country can trigger productive reflection as to how similar problems can be addressed locally with deference to local culture and local values.

Why Is Property Asset Management Important and Why Now?

On a global scale, two almost disconnected universes are attempting to cope with issues of public property asset management. The time seems ripe to try to bridge the gap between the two. At one end are a few national governments (e.g., the governments of Australia, New Zealand, and Canada) that have designed and implemented significant reforms in the management of the property under their jurisdiction. There has been some bilateral exchange of experience among these governments, mostly informal, as well as between them and other governments attempting to reform their asset management systems. For example, the Canadian reform was influenced by earlier reforms in New Zealand, and the Canadian approach to governmental property information systems was then studied by the U.S. General Service Administration. Despite these exchanges, it is fair to say that the combined experience of advanced reformers has not been sufficiently reviewed or assessed. At the other end of the spectrum is a truly global surge of interest in property asset management reforms among countries that have not yet advanced far with the reform process. A significantly larger number of countries belong in this group compared with the size of the pool on the reform side. It should be noted that the right of local governments to hold property is defined in the constitutions of many countries and in the legislation governing lower tier governments.

The clamor for property reform appears to be growing across an entire spectrum of pre-reform countries. In January 2003, the General Accounting Office in the United States declared that management of federal property represented a new "high-risk" area in overall government management, due to persistent difficulties in implementing modern standards of property asset management (Walker 2003). In Russia, the same issue has been high on the reform list since the 1990s. France began to codify and institutionalize reform efforts in 2001. From 1999 to 2003, the governments of China, Indonesia, Morocco, Chile, Kuwait, and several states of the former Soviet Union, among others, requested technical assistance on the issue from international donor organizations. In this context, an attempt to identify problems and consider the suitability of reform remedies tested by advanced reformers is timely.

At levels below that of national governments, the situation is similar. Usually the need for

reform is even more dramatic. There is widespread recognition of the need to better manage municipal property in most cities in the world. Structural problems across regional, state, and territorial governments that have legal powers to own and maintain real property are surprisingly similar, regardless of the level of development in each country. Even in most developed countries, improvements are urgently needed, beginning from a very basic level, such as property inventory records, as later chapters demonstrate. The need for better management of locally owned government property has been highlighted on a global scale by the widespread decentralization initiatives that often have devolved huge property portfolios from central to local governments almost "overnight," while municipal or regional governments were and continue to be unprepared to deal with multiple issues related to the role of property owners and managers.

The notion of "good practice" in property asset management at the local government level is complicated by the different legal rules and accounting conventions in effect in different regions of the world. In Roman-law countries, government-owned properties are divided into two major groups: (1) those belonging to the "public domain," which implies that property cannot be alienated (i.e., sold or mortgaged) without special prior legal actions and also may have limitations on use and management arrangements, and (2) those belonging to the "private domain," where publicly owned property is regulated similarly to privately owned property. In common-law countries, this legal difference does not exist. The legal diversity is further increased by Scandinavian law, which combines elements of both common and Roman law (Management of Municipal Real Estate Property 1999, 7). Unlike most Western countries, which do not have special legislation governing municipal (as opposed to private) ownership of property, in former socialist countries, municipal ownership typically is addressed in high-level law, such as the Constitution or Civil Code, as a separate form of ownership with its specific rules. Although the legal rules are often distinctive to each country or region, many of the concepts they deal with—such as the difference between inherently public-purpose property and property that happens to be owned at a particular point in time by a public sector entity—arise in most countries and under most institutional arrangements.

Drivers of Reform

The demand for property asset management reform in any given country or local government derives from a unique set of circumstances. However, there have been a few common drivers of the reform effort, easily recognizable across most locations:

New Public Management

Reforms in property asset management belong to a realm known in the public administration literature as New Public Management (NPM), which has emerged over the past two decades as the dominant public administration model (Glore 2001; OECD 1995). There is no formal definition of NPM. The most commonly identified elements in the literature include the implementation of such key initiatives as

- improved performance (especially financial efficiency and cost-effectiveness), supported by performance monitoring and incentives;
- a redefined and reduced role for the public sector in the economy, including privatization or commercialization of previously public enterprises and services, increased contracting, and application of private-sector management approaches to the public sector;

- separation of policymaking and service delivery functions;
- decentralization or devolution of service responsibilities from higher to lower levels of government;
- greater managerial flexibility in financial management; and
- greater accountability and transparency in government operations

According to a literature review by Glore (2001), the United Kingdom, Canada, New Zealand, Australia, the Netherlands, Sweden, and in some respects, the United States are considered the most advanced implementers of NPM. For these countries, reforms in property asset management have occurred as a subset of a more general overhauling of public administration and the role of the public sector. Countries just now starting to address real property management typically view reforms in this sector as part of a broader governmental reform agenda.

Recognition of the Financial Payoff to Better Real Asset Management

Much of the impetus for reform has come from recognition of the large amounts of wealth tied up in public-sector real assets and the income or cost-savings to be obtained by changing management practices. The reform of accounting practices, including the shift to accrual-based accounts and movement toward more international uniformity in accounting practices is also having an effect. Budget constraints, while prompting cost cutting measures, have also accelerated approaches to manage better the assets needed for governments to function and initiated the search to raise revenues from such assets. These budget constraints take various forms. They may result from lower overall public-sector revenues (sometimes induced by the deliberate choice to reduce taxes) or from the devolution of service responsibilities from central government to lower levels of government without commensurate transfers of revenues. Or, in many developing countries, the budget constraint may result from the fact that local authorities have very limited (or no) flexibility to raise local tax rates or to impose new local taxes. Their primary options for raising revenues may involve charging for the use of public property or selling it, necessitating that they give high priority to property management.

The financial stakes involved in property management and disposition are especially high in the case of land. Unlike most other physical assets, land can be a vehicle for managed capital appreciation, particularly when governments themselves are the primary source of allocating development "rights" and constructing the public infrastructure that get translated into added value. When public authorities open up new lands by building roads, providing infrastructure services, or relocating public offices, they create incremental land values, sometimes of great magnitude. When public authorities own the land in question, a shrewd infrastructure investment strategy, coupled with changes in the land use designation, can recapture large portions of the costs of capital investment, and in some cases the entirety of costs, from land value appreciation and subsequent land sales. Major Chinese cities, for example, are financing the costs of high-traffic ring roads around the city periphery by selling adjacent land parcels, with assigned land use rights, usually over a period of six to eight years. In the meantime, they have borrowed the monies needed for road construction through loans collateralized by these land parcels.

The following three examples convey an indication of the sums potentially involved in land and property management and disposition:

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- In Changsha, the capital of Hunan Province, an interior province of China, an eight-lane ring road is being more than 50 percent financed solely by the sale of publicly owned adjacent land (and interim borrowing against the value of the land parcels). The roadway is estimated to cost US$730 million (see chapter 7).
- Panama, at the time the United States turned over the Canal Zone, was one of the most highly indebted nations in the world, as measured by the ratio of public debt to gross domestic product. However, a study of the property contained in the Canal Zone estimated that if the property were gradually released to the market through competitive sales, the discounted present value of the land would exceed Panama's entire national debt. Land sales could have been used either to eliminate public debt or dedicated in part to a national endowment fund to be used for priority national investments, both in physical assets and human skills training. Instead, much of the land was allowed to lose its value by being overrun by municipal garbage dumps, informal and unregulated housing, and noneconomic use by the nation's military (Peterson 1985).
- In the United States, the General Services Administration (GSA) estimated the nation's potentially marketable real estate portfolio at $335 billion. In the face of tightening budget constraints, GSA and other federal agencies are looking for ways to extract financial value from surplus or underused property. In one transaction, GSA auctioned 240 acres of a decommissioned California Navy base for US$208.5 million to a housing developer. A decommissioned Marine Corps base in California is scheduled to be auctioned as four separate parcels totaling 3,700 acres and estimated to generate proceeds between $500 million and $1.2 billion (Wall Street Journal, Oct. 13, 2003, p. B1).

In New Zealand and Canada, both of which had multiyear national budget deficits on the eve of asset management reforms, massive privatization of property holdings was considered, by design, as a way to achieve a dual financial benefit: reduce recurrent operating expenses and obtain one-time sales revenues.

As noted, a deliberate "downloading" of programs, services, and property from higher-level governments, as part of decentralization initiatives, has taken place in numerous countries throughout the world—often without adequate sources of funds to pay for the devolved programs in the traditional way. One can see the results of this trend in Canada where the federal government now runs a surplus, while provincial and municipal governments face formidable deficits. The federal government passed along financial liabilities to lower tier governments, but retained most of the taxing powers. Program devolution also has intensified local budget constraints in the United States and many developing countries.

Faced with intense fiscal pressure and limited sources of revenue beyond property taxes, local governments have had to rethink how they manage real property assets. Traditionally, municipalities sought to supply the amount of property needed to deliver local public services, and this was an annual capital expense written off at the time of construction or acquisition. This objective was later modified so local authorities compared the costs of direct ownership with feasible alternatives, including renting property from private owners. This allowed them to capitalize the expense over the term of the lease. Subsequently, under the pressure of fiscal and economic constraints, many local governments have considered whether the private sector can more effectively build and operate important capital projects, and investigated options for selling or otherwise extracting greater economic value from the physical assets they already own. There has been a push among some governments, given

their mounting debt, to seek "off balance sheet" options for what were traditionally public capital expenditures. An agreement to build a private toll road or a "sale leaseback" would be two examples.

Accounting Reforms

The reform of accounting practices in the government sector has strongly influenced property asset management. A move to accrual accounting and generally accepted accounting principles (GAAP) has spread across much of the developed world and is swiftly making inroads (often with donor pressure) into developing countries. These accounting changes can have drastic implications for the way real property assets are accounted for, and the kind of information flows that are needed to comply with newly adopted accounting standards. Accrual accounting and GAAP standards bring greater clarity to how property-related costs and property values are recognized and measured over time, but their adoption requires more than a simple change in reporting procedures.

From a public finance point of view, local governments in Canada and the United States have traditionally operated via annual budget requests and annual appropriations assigned on the basis of these budget requests. This approach typically eliminates the need for any type of balance sheet since all transactions are annual cash transactions with carry-over provisions. Capital assets are written off in the year completed, and the value of these assets is not accounted for in public ledgers. This implies that real property held by government is a nonproductive asset or free good. There is now underway an effort to revamp the entire accounting system for real property, starting with mandatory reporting of a local balance sheet that recognizes local capital assets and liabilities. How this initiative will play out in the end is still in question. However, the effort to value physical assets for accounting purposes has forced authorities to focus on such critical question as how, precisely, physical assets of different types should be valued and how such valuations can be made more useful as management tools, not mere reporting requirements.

Balance sheet accounting for real property assets has a longer history in Australia, New Zealand, and Western Europe, and there may well be lessons that other countries can learn from this experience. Even among Council of Europe countries, though, accounting practices have differed considerably. Accounting differences translate into differences in recognition of property-related costs and property values, which further affect how property managers perceive and treat their property. In the next few years, there will be the push to carry public real property assets at market value, not book value. This will cast an entirely different light on many public portfolios as liabilities such as soil contamination or deferred maintenance erode perceived value and perhaps push some assets into the negative column in terms of market value.

Entry of Real Estate Professionals into Public Property Management

A final factor driving changes in government-owned property asset management has been the entry of real estate professionals into the field. A close look at "good practices" reveals that in most cases these were practices transferred from private-sector real estate management under the direction of real estate experts retained by government. For example, a comprehensive approach to real property asset management in Denver, Colorado, in the 1980s, which still remains among the most constructive conceptually and practically, was introduced when a real estate expert was appointed to direct asset

management in the city government (Utter 1989). One of the most significant advances in government property asset management resulted from recognition that the methodology used by private-sector, non-real estate corporations (i.e., corporations whose main business is not real estate) for managing their real property offered a valuable prototype for local governments (Simons 1993).

Some Common Issues of Pre-reform Asset Management

An important step in searching for internationally transferable experience in managing governmental property assets is to identify the similarities between problems that pre-reform governments encounter. The list of practically universal problems includes the following, some of which remain active on the agendas even of countries engaged in significant reform efforts:

Lack of a Central Policy Framework

Only in the past two decades have governments begun to understand the full implications of managing their property assets. The initial response was to question the processes governing acquisition and disposition real property, followed by forays into outsourcing services such as property sales, property maintenance, and accounting practices. The challenge was directed at those who managed these assets, relatively small groups in the overall scope of government. Only recently have governments begun to realize the efficacy of implementing broad policies that address the users of these assets as well as the managers. This policy framework must come from the highest levels if it is to be effective. Australia was perhaps the first country that introduced such a policy, and of a very radical nature, as demonstrated in chapter 2. Canada is another example: the Treasury Board is significantly revising its policy framework as it affects the users of real property. The new policy framework replaces a plethora of policies, guidelines, and regulations with policy statements that are markedly simpler, are more consistent, embody greater clarity of purpose, and apply across all branches of government.

Such a policy framework must be driven by a clear understanding of why a government acquires or retains real property and what steps are required if that need no longer exists. Unfortunately, even with the best of intentions, the policy framework is vulnerable to political exigencies, particularly in situations where governments may wish to utilize real property to symbolize power, status, or presence. In the mid-1990s, the Canadian government, amid the turmoil over the possible separation of Quebec, halted the sale of some surplus property assets based on the perception that their sale might diminish the physical presence of the federal government across Canada. The Canadian government went to the extraordinary step of requiring plaques to be installed on many federal buildings as emblems of the federal presence—an initiative not contemplated in the national policy framework for property asset management.

Fragmented Management of Public Property Assets

When many government agencies or other entities, such as line ministries, departments, government-owned companies, or special-purpose entities, become involved in managing, financing, and using an asset class, the management of these assets is "fragmented." A lack of government-wide strategies, policies, and rules exacerbates fragmentation. In the United States, over 30 agencies control hundreds of thousands of federal properties worldwide. In

Kuwait, which is almost a city-state, 10 government entities are intimately involved in managing state land (the number increases if we include buildings). Even if an agency is charged with the development of new real estate policies, it is common to find there are no effective "transmittal devices" that would make other agencies implement these policies.

In practical terms, fragmentation implies that criteria unrelated to asset management effectiveness or efficiency split public property into many portfolios, and these portfolios are managed quite independently. Even if some are managed well, the overall result is suboptimal. For example, the 1999 audit of the Land Bank program of Saskatoon, Canada, found that this long-lasting operation was meeting its objectives to ensure availability of suitable serviced lots at reasonable and relatively stable prices and had most elements of good asset management in place and functioning. It maintained an inventory of land in the land bank, tracked expenses and revenues on a site-by-site basis, monitored values of sites, and evaluated returns on investment for each sold site (even though the land bank program was not aimed at maximizing financial returns). The program implemented an acquisition, holding, and disposition policy that was financially rational and sensitive to market conditions. At the same time, however, the department, which ran this program and was in charge of all civic land in the city, did not even have an inventory of all municipal land holdings (City of Saskatoon, Office of the Audit General 1999).

Another typical example, Cleveland, Ohio's Land Reutilization program stands out in the United States as a model for effective management of tax-delinquent properties. The city aggressively seizes such properties and gives the owners a short time to reclaim them. If not reclaimed, the city places the property into a "land bank" specially established for handling such properties and sells it for the amount owed in back taxes or the market value (Bowman and Pagano, 1998). At the same time, the city lacks a comprehensive strategy for managing municipal real property.

Economic Inefficiencies Associated with Public Property

Economic inefficiencies, including physical and economic underutilization and insufficient maintenance and repair, stem from the fundamental belief, even in capitalist economies, that real property held by a government is a "free good," owned by the taxpayers, and not subject to the same economic rationalization that occurs in the private sector. Those that occupy or use these assets usually do so with an attitude of perpetual entitlement and see no need for any lease arrangement. In such circumstance, it is difficult for governments to assign monies for maintenance and repair since the improvements in program performance are difficult, if not impossible, to measure. One need only survey the dismal condition of the housing stock in former socialist countries such as Russia where housing was essentially a "free good" to understand the amazing similarities between socialism and capitalism when it comes to dealing with public property. Both "ideologies" were equally adept at creating multiple inefficiencies, often to the extent that deferred maintenance rendered the asset a de facto liability.

One source of inefficiency is the presence of large portfolios of vacant or underused properties, which exist generally because government departments and agencies or the scope of their operations—in other words, their demand for space—change faster than pre-reform governments' capability to reuse or dispose of properties. While government no longer requires the asset, there is no incentive or financial benefit to relinquishing it since it is a "free good" and the cost of holding the asset is not emphasized in any chart of

accounts. Examples can be found everywhere—from military facilities (on all continents) that are not needed because the Cold War is over to vacant or half-vacant school buildings in former Soviet Union countries that are not used due to demographic, economic, and social changes. (Vacancy rates can be very high in these countries, where it is not unusual to find 30 percent of total municipally owned floor space unoccupied.)

Further inefficiencies arise because the real cost of holding an asset, plus the opportunity cost, is seldom accounted for. Governments forgo financial gains and expose themselves to opportunity costs by holding vacant properties. On the one hand, they incur annual expenses for the maintenance of unused facilities (especially in developed countries; in poor countries, such properties are often left to deteriorate, guarded only from being stolen brick-by-brick by residents). The U.S. Department of Defense, for instance, estimated its annual expenses in early 2000s for the maintenance of unneeded facilities in the $3-$4 billion range (Ungar 2003). On the other hand, potential revenue is lost from leasing or disposing of the asset. Governments have a tendency to hold onto properties and thereby preclude obvious economic or social benefits. Unintentionally, they portray an image of neglect and waste within the local community, particularly when the contrast to adjacent private property is glaring.

Opportunity losses for public budgets often result from failure to capture the "highest and best use" of governmental properties. Some of these decisions are politically motivated; others reflect managerial incompetence or corruption; still others reflect disagreement as to how far the "market" should be allowed to go in dictating property use. Examples of inefficiency range from the use of well-located land sites for municipal equipment storage or waste yards to the systematic practice of leasing public property to private parties for below-market rents without benefit of competition. The latter has been an especially draining practice in many former Soviet countries: in five Russian cities surveyed in 1997, municipal rent was only 3.5 to 7 percent of rents of comparable properties on the private market; in Yerevan, Armenia, it was 20 percent or lower in 2001; and in Bishkek, Kyrgyzstan, municipal rents were 22 percent of private rents on average.[1]

Finally, deferred maintenance and repair of government-owned properties is the norm and not the exception across both developed and emerging economies. Part of this problem is attributable to accounting practices and the lack of recognition of real depreciation on the balance sheet, although many other factors encourage postponement of maintenance costs. The U.S. General Administration Office, which manages only about 10 percent of the government's space, estimates its backlog alone on maintenance, repair, and alterations at approximately $5.7 billion (Perry 2003). In Morocco, resources allocated annually for maintenance of property portfolios of the health, education, and higher education sectors are estimated to cover between 5 to 10 percent of the amounts needed to maintain property quality, according to the World Bank (International Bank of Reconstruction and Development 2003). In most cases, the amount of deferred maintenance and repair is not known, even at the level of estimates—though the severity of maintenance backlogs is manifest from the dilapidating shape of properties.

Lack of Information Needed for Managing Property Portfolios

Even among advanced reformers, information about real property has been an issue until very recently. As of 1996, only 65 percent of all local authorities in New Zealand and 66 percent in England and Wales had their property records computerized (Bond and Dent

1998).[2] As of 1997, Washington, D.C., had duplicative and inconsistent inventory records of buildings that the city owned and a substantially incomplete inventory of in- and out-leases, not to mention more comprehensive—for instance financial—information (Asset Management Reform 1997). Even in early 2002, there was no reliable government-wide data on property holdings of the federal government in the United States; its worldwide inventory lacked such key data as space utilization, facility condition, historic significance, etc. (Ungar 2003). Since then the quality of inventory data in the United States has improved, but it is safe to assume that inventory deficiencies are the norm in most places.

Conspicuously lacking in most attempts at property inventories is reliable financial information. Revenues and expenses are not tracked on a property-by-property basis mainly because this information is not collected within governmental budgeting systems. The potential market value of real estate is also frequently unknown, even for obviously marketable and legally alienable properties. Bookkeeping values for property often are so outdated as to be meaningless.

Without lease arrangements and access to the information that a lease document provides, it is inconceivable how effective management practices can be instituted for many categories of property. Leases record everything from the quantity of space consumed to the assignment of operating costs. Detailed recordkeeping is essential to cope with owner-tenant disputes, ascertain market trends, set prices, determine values, and compare performance against industry standards and benchmarks. One solution to the lease dilemma is to privatize entire asset classes, such as housing. For assets that remain, governments are often remiss on lease arrangements; some even add to the confusion by using a mixture of leases and "nonlease" assigned space, without understanding why they do so other than historic arrangements.

Lack of Transparency and Accountability

It might be assumed that opacity in real estate dealings is a problem primarily of less developed countries, but such is not the case. Suspect dealings, "insider" transfers, secretive rezonings of land parcels, and other abuses are elements of real estate transactions almost everywhere. Real estate is a transaction-driven business often involving large sums of money. Wealth is created by conferring leasing, development, or transfer rights through a political process not subject to the same scrutiny found in other sectors of government. Politicians seem to have a particular affinity to becoming involved in real property transactions. They might see demand for transparency and accountability as limiting their potential involvement. Whatever the cause, transparency reforms in public real estate transactions lag well behind reforms in government procurement, another area where abuses traditionally have been found but where written procedures and mandatory use of competitive bidding have reduced the scope for corruption.

The real estate practices of developed countries are not the best example to set for emerging economies, where the idea of accountability and transparency is still alien. In this tier of countries, the executive branches of governments often fiercely oppose the introduction of competitive procedures for property disposal since informal income from corrupted property allocation represents a significant source of illicit payments.

Unresolved Big Issues

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CHAPTER ONE

Some of the conceptual directions incorporated into advanced reformers' agendas are clear. There is agreement that more importance should be assigned to economic efficiency in the use of real property and that a primary means of achieving this end is to move toward market principles in property and rent valuations, while at the same time looking for productive opportunities to partner with the private sector. Moreover, the search for economic efficiency resulted in massive privatization of whole property classes, such as retail property and some types of public housing. Currently, it is widely agreed that public property cannot be viewed as a free good. (Canada, prior to property asset management reform, reported all fixed assets on the balance sheet at a nominal value of CAN$1.00.) There also is agreement that since property management is not the primary purpose of government, useful analogies can be found in the property management practices of non-real estate corporations that mostly produce other goods or services but, in the process, manage real property and seek to do so efficiently. Property asset management reform as practiced in the advanced reform countries, however, has left unresolved several "big issues," which are addressed throughout this book.

Relationship between Accounting and Asset Management Reform

One such issue is the *relationship between accounting reform and asset management reform*. This issue is a bundle of accounting issues: (1) how far should asset valuation on the balance sheet be pushed for real properties the government owns, (2) how does shifting to accrual-based accounting standards affect property accounting and management, and (3) how much importance should asset management policy attach to accounting rules?

Valuation of public property is not without its critics. There are those who would argue that it makes no sense to attach a market value to properties of an intrinsic public-use nature, such as a national park. Obviously, it can never be sold, nor would it be easy to identify a potential buyer. Critics also argue that particular assets, such as parks, should not be placed on the balance sheet since they would distort the numbers. For example, in the United States, a special type of so-called "stewardship assets" is not reported on the government's balance sheet (these assets include national defense facilities, wilderness areas, scenic river systems, and monuments). A valuation and revaluation exercise for all government properties has also been questioned from a pragmatic viewpoint due to its high cost. Arguments can be made to exclude such properties as monuments, bridges, and other installations if they are not subject to privatization in the near future (although in China, several municipalities have recently leased major bridges on a multiyear basis to private purchasers.) From a methodological viewpoint, experts have debated whether using market-value estimates for accounting purposes is credible for nonmarketable properties, such as infrastructure facilities, where no market comparables exist—specifically, whether appraisal standards established in the private sector are achievable in such cases (see, for example, Bond and Dent 1998).

The use of market valuations is clearly expanding, however. Advanced reforming nations like New Zealand and Australia require bookkeeping values of real property assets be periodically revaluated based on their estimated market values, not just based on acquisition cost and adjusted for subsequent depreciation and capital improvements. International organizations also promote using market valuations; two examples are the International Federation of Accountants in their *Public Sector Accounting Standards of 2002* and the International Monetary Fund in their *Government Finance Statistics Manual of 2001*, though neither of these systems is binding for governments.

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The introduction of market valuations, at least for alienable properties, reflects similar trends in the private sector and offers many of the same benefits in terms of improved asset management practices. Just how extensive market valuations should be applied across the full spectrum of public real property assets is still a matter of keen debate. For some asset classes, such as national parks or nature reserves where financial performance is not a prerequisite, the benefits of market valuation are far less clear. This debate is most spirited in countries, like Australia, that have mandated unified standards, including property valuations (Barton 1999; Carlin 2002). However, it should be recognized that the debate over market valuation is equally spirited among private sector asset managers, many of whom still uphold old practices that rely on book value and view depreciation as strictly an accounting term.

Similar to market valuation, accrual accounting has triggered some controversial changes in property asset management. In accrual accounting for government, financial statements should report all assets, liabilities, revenues, expenses, gains, and losses. For capital assets, accrual accounting shows asset values and related debt. This implies that governments should identify and record all their real property assets, attach a value to each property, and then reevaluate these properties on a periodic and consistent basis.

Accrual accounting also matches a revenue stream associated with occupancy to offset the annual charge associated with amortizing capital cost. That is, if real property capital is amortized over 30 years as an "expense," a corresponding revenue stream is shown on the other side of the ledger. This revenue stream is derived from a "capital charge," which is a proxy for "rent" and is a form of transfer pricing. This capital charge is assumed to be comparable to "market rent." It may be either an imputed charge or an actual payment and is introduced as the primary means to force users to recognize the true cost of using and consuming real property. Accrual accounting may also assign a capital charge for holding surplus property to reflect the opportunity cost of withholding the property from its highest and best use. This forces agencies to dispose of such property in a timely manner. However, a problem arises with depreciation. Some charge can be assessed on the expense side for depreciation, usually a percentage of the capital cost, but without a corresponding entry on the revenue side to match this liability, the balance sheet rapidly accumulates an amount for deferred maintenance, something to which central governments do not wish to admit. This deferred maintenance, if allowed to persist, has a very significant impact on the net worth of the total portfolio.

At this stage in the transition, the potential benefits of the switch from cash to accrual accounting appear to outweigh the negatives, but accrual accounting is not the panacea that some claim. The "accounting approach" can easily overshadow the true needs of real property asset management reform and divert attention and resources from implementing effective management systems. If not tied to an annual budgeting system with accurate information on both the expense and revenue side of the ledger, accounting systems may satisfy accounting practices that deal with historic data, but do little to promote management systems that deal with future scenarios. Some authors have claimed that a capital charge may result in the systematic overpricing of public sector goods and services (Carlin 2002).

Accounting reform in the government sector is a work in progress, even among the majority of advanced reformers. It was first legislated in New Zealand and the United Kingdom from 1986 to 1989, but its implementation has been staged over time and is not yet finished in

New Zealand. In Canada, the Minister of Finance announced in 1995 that the reporting of the federal government's financial transactions would be on a full accrual basis, comparable to the private sector. The accrual accounting transition protocol was developed from 1999 to 2000, with implementation planned for 2001. However, not until 2003 did the Minister first report all assets on an accrual basis. The Governmental Accounting Standards Board in the United States introduced accrual accounting standards for local governments in 1999, and implementation spanned several years.

Separation of Ownership from Management

A second unresolved "big issue" is *the degree of separation of ownership from management*. This separation varies widely from government to government, from departments granting private firms short-term service contracts such as for cleaning or security, to long-term concessions of governmental properties, to full privatization. Privatization can take many forms, from public-private partnerships (so-called P3s) to sell/lease-back arrangements. Among advanced forms of separation, two common and distinctly different models are employed. Lessons from using each model, along with its advantages and disadvantages, can help countries starting to move forward with property asset management reforms.

The first model assumes a government retains direct ownership of property assets (or at least the biggest part of the "bundle of rights" associated with ownership) and delegates asset management functions to another entity, usually by contract. Under the second model, property assets, along with asset management functions, are allocated to a separate legal entity owned by the government (in Western countries, this entity is often a corporation). In such a case, the corporation, not the government, owns the assets, while the government owns or controls the corporation. These models evoke a number of questions, mainly about how these asset management entities and the relations with them are governed. In particular,

- To whom is the entity accountable? Are political masters the only ones truly accountable?
- What kind of legal and regulatory framework is needed to establish such entities? Is the entity created by a charter or letters patent, or by special legislation?
- What document defines the working relationship and mutual rights and responsibilities of the government and the special entity?
- What reporting requirements and regulations apply?
- What powers reside within the entity? Can it encumber public assets with project debt such as a mortgage? Can it run deficits? What are its spending and approval limits?
- What risks can it incur and does it have the capacity to mitigate these risks? How does it cope with political risk?
- On whose balance sheet—the government's or the managing entity's—should assets be kept?
- What are the accounting rules governing the entity (in particular, when should it follow private sector accounting and when public)?
- What are the requirements for valuing its assets?
- Who are the shareholders and what do they receive? If government owns the entity, can it withdraw capital or receive dividends?

Further clarification and systematization of approaches related to these questions seem especially important for governments at all levels in countries with emerging markets,

where the relationships between governments and enterprises controlling public property much too often generate costly mistakes. The following example is typical from the Russian Far East to countries of former Yugoslavia. Suppose the government transfers municipal income-generating properties to the balance sheet of so-called "municipal enterprises" involved in various business activities (often not related to delivery of municipal services, or only remotely related). Two common scenarios result: either an enterprise becomes tax delinquent and property from its balance sheet is sold by court ruling to pay back taxes, or an income stream from properties is channeled to the enterprise handlers, without public budgets benefiting.

Information Systems

A third "big issue" is *information systems*. Conceptually, this issue appears to be the least clear, especially when it comes to central governments' property. At the level of property management, the information needs seem sufficiently clear (though rarely fulfilled) because they are informed by long-established private sector practices. However, at the portfolio level and above (which includes agency-wide and government-wide levels), what should be in the system is substantially less clear. What are the purposes of the information system? What kind of information does it have and why? In particular, does it incorporate physical conditions, tenants and use, and financial data on a property-by-property basis? In countries undergoing accounting reform, what is the relationship between information needed for prudent asset management and for complying with accounting standards, and who is in charge? What is the structure of the information system—is there a single "system" or are there multiple integrated or connected systems? Should a centralized system on governmental property exist at all? Even among advanced reformers, the answers are quite different. Canada, for example, has been developing a purposefully designed centralized system, while in New Zealand, the lack of a centralized property depository is considered a natural outcome of the adopted system of public management.

This book should help articulate the conceptual principles and practical problems associated with these issues.

Book Preview

Part 1 is dedicated to deriving lessons on managing the property assets of central governments from the experience of four countries, including advanced reformers Australia, Canada, and New Zealand (chapters 2-4), and France, which is at the initial stages of asset management reform (chapter 5). All "country profiles" are developed within a unified framework that includes the following sections:

- the process and key drivers of state real property asset management reform,
- legal and regulatory framework of public real property,
- institutional framework of the state real property asset management,
- inventory of state real property assets,
- system of accounting and fiscal management of state real property assets,
- the cycle for state real property asset management (i.e., policies; norms and practices for construction, acquisition, operation, and maintenance; and disposal of these properties), and
- strengths and weaknesses of the current system.

Chapter 6, the last in this section, reviews and generalizes similarities and differences among national systems reviewed in previous profiles and outlines features of a "composite image of reform" that other countries can employ. It also reflects on the sequencing of asset management reform measures.

Part 2 presents managing the property assets of local governments from several, and quite different, viewpoints. Chapter 7 discusses the interplay between the balance sheet and income/expenditure approaches to local financial management and suggests a rational balance between the two, which may differ according to the relative importance of discretionary fixed assets and discretionary local revenues. Three chapters discuss the practices and challenges of local government asset management in three developed countries: municipal asset management in U.S. cities (chapter 8) and Switzerland (chapter 9), and asset management at the Lander's level in Germany (chapter 10). The differences and similarities that emerge from these three chapters are especially interesting, as Germany and Switzerland operate within the Roman-law system, which defines limits to local asset management quite differently than American cities do. Finally, two chapters are dedicated to municipal property asset management in countries with transition economies. Chapter 11 presents a detailed review of issues and problems that local governments face as owners of huge property portfolios. Chapter 12 summarizes experiences and lessons learned from providing technical assistance on asset management reform to local governments in these countries.

Part 3 deals with issues of special interest—information systems for public property asset management (chapter 13) and forms of separating property ownership and management through two different mechanisms: special corporations (chapter 14) and a new generation of public-private partnerships (chapter 15).

Finally, chapter 16 summarizes the editors' perspectives on key issues arising from the various chapters and examines the scope of further research and analysis that may shed more understanding on asset management in the public realm.

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Notes

1. These estimates are based on the data from the Urban Institute reports prepared under various technical assistance projects sponsored by the U.S. Agency for International Development or the World Bank.

2. Though, reportedly, by 1999, local governments in New Zealand completed computerization of their property holdings.

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CHAPTER ONE

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