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REAL PROPERTY ASSET MANAGEMENT

Manual for Local Governments in the Philippines



September 2017

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REAL PROPERTY ASSET MANAGEMENT

Manual for Local Governments in the Philippines

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Equity (SURGE) Project

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PREFACE

Asset Management Reform (AMR) aims to build the managerial/administrative capacity of local governments and to provide policy advice on local government reform. The Urban Institute, a nonprofit policy and research organization based in Washington, D.C., implemented a previous initiative in this area under the Local Government Reform Project. This was funded by the United States Agency for International Development (USAID).

The Manual aims to assist the local government units, particularly Cities in the Philippines to appreciate and understand the principles and processes related to asset management model focusing on real property (land, property and fixed assets). It serves as a basis for efficient and effective implementation of new management techniques. Through USAID's SURGE Project, this be will be refined and updated over the course of implementation in Cities Development Initiative (CDI) partner cities with information gained from new "lessons learned" and deeper application of asset management methodologies. Thus, the manual will be updated and refined over the course of asset management implementation.

GLOSSARY

Acquisition

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

Acquisition cost

Newly acquired machinery not yet depreciated and appraised within the year of its purchase, refers to the actual cost of the machinery to its present owner, plus the cost of transportation, handling, and installation at the present site. The cost may also include freight and insurance charges, brokerage, customs duties and taxes¹.

. Appraisal

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

Appraiser

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

Asset

An item of monetary value. Assets are the resource base of a functioning entity and local government assets serve the same purpose for LGU operations. They can be used by LGUs to help them achieve their objectives: they can be put into productive use or they can be sold, transformed and otherwise disposed of to benefit local treasuries and ultimately the citizenry².

Asset Management

Asset Management may be described as a process that optimizes the utilization and disposition of properties with material value to justify asset management costs and existing and usable at

¹ BLGF, *Manual on Real Property Appraisal and Assessment Operations*

² BLGF, *Manual on Real Property Appraisal and Assessment Operations*

the time of preparation of asset management plans, operated, or with potential, for profit; extensively used in the delivery of mandated and/or social/cultural services, and idle or not being used³.

Asset Manager

A representative of a property owner who, through strategic planning, is responsible for maximizing the value of a property through the lifespan of ownership. Activities include financial analysis, analysis of property operations, decisions regarding Capital Improvements, and oversight of the performance of the Property Manager.

Book Value of Real Property

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

Broker

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

Capital Improvements

Additions to a real property unit that add value through extending its economic life, increasing its potential rental income, reducing its operating expenses, or improving the comfort of its occupants. Examples include replacement of the roof, installation of energy-conserving components such as insulation or improved air conditioning equipment, and adding space to the building. Excluded are items such as fuel, roof repairs, painting, and other routine maintenance and repairs.

³ Local Asset Management in the Philippines Final Report. Asian Development Bank Study, 2008

Cash Flow

For purposes of this text, the periodic income associated with the ownership or control of a real property unit. Cash flow in this context does not include the profits from operating a business in the property. Cash Flow is customarily positive, but may be negative as in the case of a property with no occupants, property devoted to a social function, or property used for a core function such as city hall. Net operating income may differ from cash flow to the extent of mortgage payments and other transactions associated with the real property unit but not resulting from its operations.

Centralizing Responsibility

The process of assigning one department (in this context, an Asset Management Unit) the entire responsibility for an asset. Specific duties such as property Management and Appraisal may be delegated to other unit(s) or companies but the ultimate responsibility remains with that unit. If delegated duties are not performed at a satisfactory level of cost and quality, then the Asset Management Unit can terminate the delegation and reassign the duties to another supplier of services.

Core Function

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

Cost Approach (to Property Appraisal)

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

Depreciation

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

Discounted Cash Flow (analysis)

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

Disposition

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

Gross Income

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

Fair Market Value/Market Value

The price at which a property may be sold by a seller who is not compelled to sell and bought by a buyer who is not compelled to buy; Market Value is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in arm's length transaction (a transaction between independent, unrelated parties involving no irregularity) after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion⁴.

Feasibility Study

An analysis comparing the costs with the benefits of a potential investment and/or examining whether it will satisfy the objectives of the investor.

Fixed Asset

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

⁴ BLGF, Manual on Real Property Appraisal and Assessment Operations

Improvements

The general term describing all relatively permanent additions to land. Examples include buildings, paved parking, connections to utility systems (such as water, sewer, and electricity), and fences.

Income Capitalization Approach (to Property Appraisal)

The process for arriving at a value indication by (a) estimating Cash Flow and dividing it by a market-based rate of return or (b) finding the net present value of estimated future cash flows from income and the eventual sale of the property using a market-based discount rate. (See Discounted Cash Flow.) This can be one of three approaches that may be useful in estimating Market Value. The others being the Sales Comparison Approach and the Cost Approach.

Indirect vs. Direct Subsidies

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

Life Cycle Cost

The total cost of owning, operating, and maintaining a real property unit over its useful life.

Maintenance and Repair

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

Management

See Property Management.

Market Value

Is the price agreed upon by the buyer and seller in the open market in the usual and ordinary course of legal trade and competition; the price and value of the article established or shown by sale, public or private, in the ordinary way of business; the fair value of property is between one who desires to purchase and one who desires to

sell; the current price; the general or ordinary price for which property may be sold in that locality⁵.

Multiple (Mixed) Use

A combination of different but compatible uses of various Premises within a real property unit. An example is a building with retail stores on the ground floors and residential apartments or offices in the upper floors.

Net Income Ratio

Net Operating Income divided by Effective Gross Income, usually expressed as a percentage.

Net Operating Income

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

Non-Traditional Role of Government

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

Operating Expense Ratio

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

Operating Statement

An accounting statement showing all revenues and expenses associated with the operation of a Real Property Unit and sorted into categories of transactions such as rental income, Maintenance and Repairs, electricity, and taxes. An Operating Statement should include the categories necessary to accurately reflect the financial performance of the operation the Asset. The Operating Statement shows Net Operating Income.

⁵ BLGF, Manual on Real Property Appraisal and Assessment Operations

Portfolio Manager

An agent (representative) of a property owner who, through strategic planning and financial analysis, is responsible for maximizing the value of a portfolio of properties through the lifespan of ownership. Activities include recommendations and decisions (within the scope of delegated responsibility) regarding the entire portfolio including the determination of financial and other (perhaps social) objectives, risk tolerance, and the allocation of capital among types and geographical locations of properties. This role encompasses property management and asset management but considers broader objectives and strategy rather than individual property details.

Premises

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

Property

All rights and benefits associated with ownership of an Asset or class of Assets.

Property Consumption

A type of property that an individual does not use for business purposes or hold as an investment. In other words, property that an individual owns for personal enjoyment. These may also refer to assets based on their contribution to autonomy, dignity, or freedom⁶.

Property Level Accounting

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

Property Management

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

⁶ www.investopedia.com/terms/p/personaluseproperty.asp

Property Manager

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

Public-Private Partnership (PPP)

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

Real Property

Includes all the rights, interests, and benefits related to the ownership of real estate. Ownership of real estate is evidenced by a Certificate of Title, Free Patent or Tax Declaration in the absence of Certificate of Title⁷

Real Property Portfolio

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

Real Property Unit (Unit of Immovable Property)

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

Rent

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

⁷ BLGF, Manual on Real Property Appraisal and Assessment Operations

Rent Collector

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

Restitution

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

Sales Comparison Approach (to Property Appraisal)

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

Sealed Bid Competition

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

Social Function

For Real Property, a use that is viewed as beneficial to the community but not essential to the performance of the central role of the owner. An example includes housing provided to low income or elderly citizens for an amount of Rent that is less than that which could be obtained in the open market.

Social Tenant

An occupant of housing Premises who is given the benefit of occupancy at a Rent that is below that which would be paid in the open market because of personal circumstances such as low income or advanced age.

Strategic Asset Management Program

According to the ADB Report on Local Asset Management in the Philippines, strategic asset management program is defined based on these three elements:

- Asset requirements and asset management strategies are driven by defined service levels and performance standards.
- Scarce financial resources are properly allocated and managed to optimize investment in infrastructure.
- A long-term (life-cycle) approach is taken when determining asset operations, maintenance, renewal and development strategies.⁸

The same report stated that the “the key elements in the definition are the links to the service delivery and performance measures development, the means of properly allocating resources through financial and investment analysis to ensure that these resources are allocated in the most efficient and effective way, and accounting value and cost of the assets over the full life of the asset.”

Traditional Role of Government

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

(The) Triangle Formula

The formula involving income (I), capitalization rate (rate of return) (R), and value (V). If any two of these components are known, the third can be determined.

$$R=I/V$$

$$I=R*V$$

$$V=I/R$$

Use

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

⁸ Strategic Municipal Asset Management, Worley International, Ltd, Background Series 5, The World Bank. April 2000

Valuation

Appraisal

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

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I. INTRODUCTION

I.1. Objectives and the Content of the Manual

This manual is a document to guide elected officials and officers of local governments in the Philippines in improving their asset management practices. The manual should also be a useful reference for consultants who support city as well as other local government units who are determined in advancing their asset management practices. Finally, it should serve as a tool that public could use to participate in asset management and the general well-being of their local governments.

Real Property Asset Management (RPAM) is a complex and multidisciplinary issue. Therefore, the goal of this manual is not to provide detailed professional knowledge in related professional disciplines, since the scope would be overwhelming. Rather, the goal is to suggest a systematic approach for effective real property asset management, particularly improve the management of real property assets owned by city governments in Philippines.

The manual also provides models and methods based on international good practices, which were summarized and generalized by experts from the Urban Institute (UI) upon request of the World Bank.

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



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

For example, a City controls several hundred “properties.” A “property” should be a unit that can be managed efficiently and in a manner that allows the collection of relevant and useful financial performance data

One “property” includes space for three retail tenants. Is the three properties or one property with three tenants? The asset manager would choose the latter, maintaining separate tenant records but consolidating all financial information. This simplifies the administrative processes for the portfolio.

However, it is also possible, to treat this situation as three properties. The asset manager must think flexibly in order to meet the asset management goals in their jurisdiction.⁹

⁹The authors strongly encourage local governments to adopt the model and methods described in this manual to their needs and local situation. Not every activity will be appropriate for every situation. Creativity, flexibility, and thorough and detailed analysis are the keys to making this manual work for you.

I.2. Historical Development and Terms on Asset Management

Asset management is a function that originated in the private sector and has evolved over time in free market economies. Initially, owners of income properties retained rent collectors who obtained rent from the tenants and delivered it to the owner.

For this service, the rent collector received a commission of a percentage of the rent as compensation. Some rent collectors learned that they could improve the income to their clients (the property owners) by improving the property, working to reduce operating costs, and negotiating higher rents. They were the first property managers. Some property managers then learned that they could further improve the profits of their clients by thinking more broadly.

They developed capital (investment) improvement plans to improve the productivity of the property, looked more openly at potential property usage, thought about the financial structure of the ownership of the property by using mortgage debt and perhaps limited partners as investors, and otherwise further improved the performance of their clients' assets. They became asset managers. More recently, some asset managers have learned to look at all the assets of each client with the intent of reducing risk while enhancing profitability. This might involve selling some properties of a certain type (perhaps offices) and acquiring other properties (perhaps stores), or selling in a region where they owned many properties and buying others where they owned fewer properties. They became portfolio managers. This evolution has taken many decades.

Practical Application I.2.1. Role of an Asset Manager



Any asset has the potential to produce economic benefits. Those benefits are allocated among the entities holding rights to use or control the asset. The benefits may be maximized for the benefit of all entities, or may be limited through poor management or regulatory restrictions. The owner may choose to use it to less than full advantage by, for example, leaving it vacant or leasing it to an unprofitable enterprise unable to pay the maximum rent. Of course, society (through its legal system) may choose to impose regulations limiting the use of the property to less than its highest and best use. Land could be used for a factory, but society may decide to retain it as a park.

The job of the asset manager to make full use of the asset within legal and economic limitations and to ensure that the owner receives as much benefit as the market will allow. Under a market-based lease, the tenant should be required to pay the highest rent achievable in the market. This will allocate the property to the most efficient user of the space; however, the rent must not be so high as to cause the tenant to be unprofitable. The tenant must be successful in order to continue to pay rent.

The asset manager fulfills a key role in the capitalist system by maximizing the use of assets. The importance of this role should never be underestimated.

Over the past 20 years, local governments in the Philippines were provided with corporate powers to manage portfolios of publicly owned properties and actively using the methods developed in the private sector. Most local governments in the Philippines, as the owners of income properties, are in the “rent collector” stage and need to quickly move to the asset management stage to capture the potential income of their portfolios.

REAL PROPERTY AND REAL PROPERTY UNIT

The central term throughout this document is real property unit. It is critically important to agree on the understanding of this term. For asset management purposes, the understanding is the same as in the real estate sector. Specifically, real property unit (in some countries – unit of immovable property) is defined as a separate unit, which is definitely recognized and delineated from adjacent properties. The Bureau of Local Government Finance (BLGF) further defines Real Property as “all the rights, interests and benefits related to the ownership of real estate. Ownership of real estate is evidenced by a free patent or tax declaration in the absence of Certificate of Title.”

As a physical, material object, a typical real property unit is a land plot together with everything permanently attached to it (buildings, structures, infrastructure improvements, trees, among others). A real property unit may contain more than one building or structure (for instance, a school is a property unit that may consist of a land site with a main school building and a separate sport facility building). Often, a local government real property unit consists of a part of a building, such as a part of the ground floor or basement in a multi-story building (the standard term for this kind of a real property unit is premises). A real property unit may also be a vacant land plot, without any structures.

Real estate is a synonym of real property. It is the physical land and all those items, which are attached to the land. It is the physical entity, which can be seen and touched, together with all the additions on, above or below the ground. Real estate is used to emphasize a physical, material meaning of the term, and real property has a legal connotation.

FIXED ASSET

When a city real property unit is considered from the accounting point of view, it is a fixed asset, and as an asset, it is kept on the balance sheet of the local government unit. The city government, therefore, has ultimate responsibility for the asset. It can delegate aspects of that responsibility for the asset to an entity but must hold that entity accountable for the performance of the asset through a contract.

ASSET MANAGEMENT VS. REAL PROPERTY MANAGEMENT

In contemporary real estate, asset management is defined as a process of decision-making and decision implementation regarding real property acquisition, use, and disposition. Asset management is extensively used in the delivery of mandated and/or social/cultural services, and idle or not being utilized¹⁰.

This process usually involves a group of real property units (named in this context real property portfolio) and may include redistribution of use.

A typical example of an asset management decision from a city practice is as follows: a city owns two separate real property units partially occupied by city pre-school, but each real property unit is only 50 percent occupied by the pre-school; the city decides to combine the two pre-school classes in one building and to sell the vacated building to the private sector.

Real property management deals with daily operations and maintenance of a separate real property unit. Typical real property management tasks include arranging for cleaning, maintenance, small repair, landscaping on the site, and provision of security. For rental (investment) real property units, real property managers are usually responsible for working

International Experience Asset Ownership



Sometimes it appears that “no one owns” a given asset. However, every asset is owned by someone or some entity. If it appears that no private individual or entity owns an asset, the asset is most likely owned by the state. Assets that have been abandoned by private owners come under the control of the state. Usually an asset is held for a specified amount of time, after which point it can be claimed by the purported owner. This person must then prove ownership. After the holding period expires, the state may sell the asset. If taxes or other fees associated with the asset are not paid, the entity that is owed the taxes or fees may impose liens on the asset (including obtaining title to the asset in some countries) through a legal process.

¹⁰ Local Asset Management in the Philippines, Asian Development Bank Study

with tenants, such as: finding tenants, signing lease agreements, providing agreed services to them, and collecting rent. In case of the Philippine city governments, property managers are often the heads of public economic enterprises such as public terminals, markets and slaughterhouses.

In western practice, the property manager does not directly provide the cleaning, maintenance, and similar services but instead seeks bids from independent contractors that specialize in such work. The bidder offering the best price for service at a specified level of quality is awarded the contract to provide such service. The contract can be terminated at any time for failure to perform as agreed. The term of the contract is limited to perhaps a year so that the service provider is

motivated to perform well to improve the likelihood of having the contract extended. For the portfolio, this competitive process produces the best quality of service for the lowest cost.

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

SUPPORT SERVICES FOR EFFECTIVE ASSET MANAGEMENT

Asset managers need the services of property managers, and property managers in turn need the support of a variety of other service businesses such as landscaping contractors, janitorial service firms, and repair services. However, not all these services are available or meet the requirements of asset managers. Asset managers and property managers may need to assist new service businesses in getting established by, for example, providing carefully drafted but simple service requirements and by providing training so that those wishing to establish these new service businesses can become proficient in managing their businesses. The owners of

Practical Application I.2.2. Alternative Asset Management Decisions



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

- > Lease excess space to commercial tenants
- > Offer excess space to non-government organizations (NGOs) in exchange for vacating other space, which can be leased to commercial tenants.
- > Convert excess space to homes for elderly citizens who can assist in the pre-school.

Can you think of other options or choices?

these new service businesses may need a mentor. What are the important things these new business owners need to know?

- Good communications with their client whether it by the asset manager or property manager.
- Responsiveness to the requirements of the asset managers and/or property managers.
- Good quality work.
- Integrity and honesty in their service.
- Sound financial management.
- Knowledge on procurement and contract management.

It is also important that the mentor remain independent of the service business so that conflicts of interest do not arise.

I.3. Law, Rules and Regulations on Asset (Real Property) Management in the Philippines

Based on a study conducted by the Asian Development Bank (ADB) by Benjamin Geronimo and Glen Wright, “The Philippine Local Government Code (LGC) of 1991 has set the foundation for local asset management.” The authors cited the following relevant provision in the code:

- *“Empowered the local governments to **acquire, develop, lease, encumber, alienate or otherwise dispose of real or personal properties** held by them in their proprietary capacity and **to apply their resources and assets for productive, developmental or welfare purposes**, in the exercise or furtherance of their governmental or proprietary powers and functions and thereby ensure their development into self-reliant communities and active participants in the attainment of national goals;*
- *Required the establishment of an archival system to ensure the safety and protection of all government properties;*
- *Defined the primary and secondary accountability, and the responsibility for the proper use and care of, as well as, responsibility for record keeping, including measures of liability of persons accountable for them;*
- *Enumerated the procedures for application for relief from accountability and the disposal of property by auction sale or destruction;*

- *Required the approval of the auditor for the sale through negotiated sale, of real property no longer needed;*
- *Exempted the local governments from the payment of duties and taxes for the importation of heavy equipment or machineries which shall be used for the construction, improvement, repair, and maintenance of their infrastructure projects, as well as garbage trucks, fire trucks and other similar equipment;*
- *Provided for the mandatory position of General Services Officer in the provinces and cities with the function of: taking custody of and be accountable for all properties, real and personal owned by the Local Government Unit (LGU); upon approval, assign building or land space to local officials or other public officials, who by law, are entitled to such space; recommend lease rates for rental properties of the LGU and for private properties which may be leased by the LGU for official use; and perform archival and record management;*
- *Assigned to the local chief executive officers the function of:*
 - *Allocating and assigning office space to local government and other officials and employees, who by law or ordinance, are entitled to such space;*
 - ***Providing efficient and effective property and supply management*** and protect funds, credits, rights and other properties of the LGU;
 - *Empowered the local councils or sanggunians to provide a mechanism and the appropriate funds to ensure the safety and protection of all local government property, public documents or records such as those relating to property inventory, land ownership and others.*
- *Required the LGUs to maintain special accounts in the general fund for public utilities and other economic enterprises with the following objectives:*
 - *Determine whether the income generated by the public utilities or economic enterprises are sufficient to meet their respective operating costs.*
 - *Provide adequate information as to the assets, liabilities and equity of each special account.”*

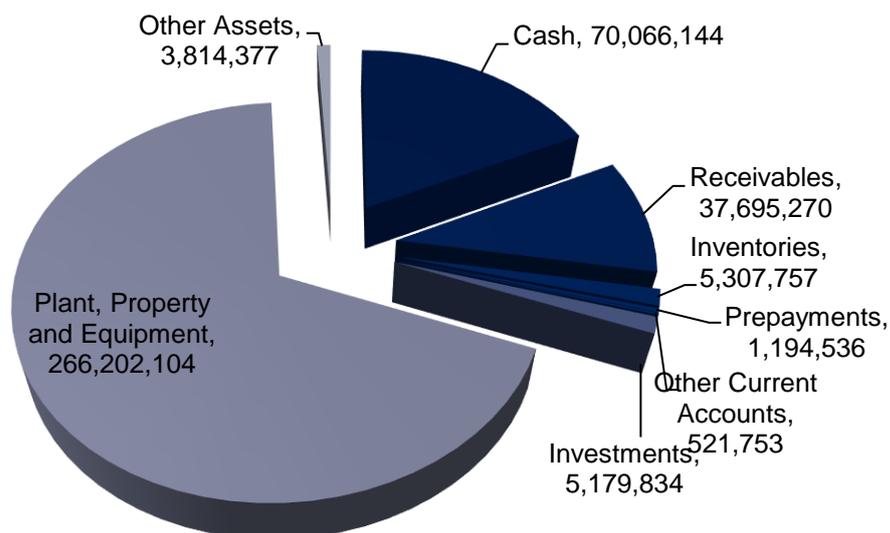
Moreover, the authors cited that the Philippine Commission on Audit (COA) promulgated rules and regulations to assist in the establishment of asset management in the local governments. The rules to setting asset management are: (1) the bonding of accountable officers, the insurance of government properties of LGUs, except those owned by cities below 1st class; (2) the requirement for physical inventory taking; the requirement to submit the annual Report on the Physical Count of Property, Plant and Equipment, per card and per count with shortage/overage, if any; (3) the requirement to set up a repairs and maintenance program;

(4) the placement of full and sole authority and responsibility for divestment or disposal of properties on the Local Chief Executives (LCEs) or mayors; (5) the provision on assets subject to disposal; (6) the prescription on methods and computation of depreciation; and (7) the promulgation of guidelines on asset disposal, property appraisal (except real property), and in describing conditions of property.

I.4. Asset Management Situation of Philippine Local Governments¹¹¹¹

The Philippine Bureau of Local Government Finance, based on the ADB report, recognized the relevance of Asset Management. Their findings showed that one LGU carried in its inventory an oil-extraction equipment inoperative and stored in a warehouse right after purchase. Other LGUs were operating public markets, slaughterhouses and other public enterprises with negative operating results. These properties are classified under Land, Building and Machinery and Equipment under the Plant, Property and Equipment account in the Commission on Audit Chart of Accounts. Table 1 supports this observation on the percentage of Plant, Property and Equipment to total assets of all LGUs in 2005, as shown below.

Figure 1. Total Assets Percentage Distribution in Local Governments

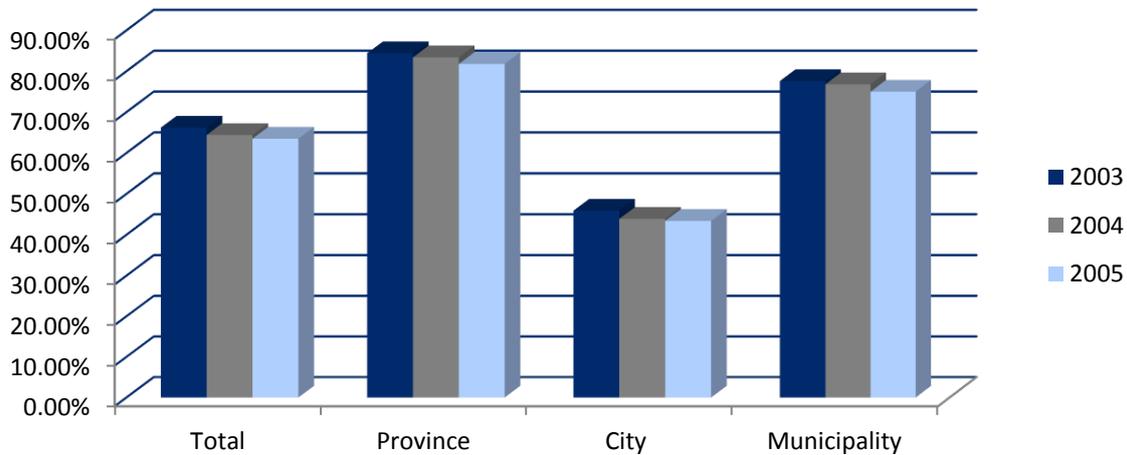


Source: Local Asset Management in the Philippines Final Report. Asian Development Bank Study

¹¹¹¹ Local Asset Management in the Philippines Final Report. Asian Development Bank Study

Table 2 shows the dependence of local government units on national transfers (often referred to as internal revenue allotment or IRA).

Figure 2: Dependence on national transfers



Source: Local Asset Management in the Philippines Final Report. Asian Development Bank Study

Furthermore, the ADB report cited that the asset situation in Philippines are often characterized by:

- Rapid devolution of property has made many city governments the largest property owners in relation to other tiers of government.
- Large real estate portfolios are being transferred from direct city ownership into ownership by enterprises that are owned by cities.
- Fiscal disincentives for further privatization.
- Large portfolios of social or core service properties with negative cash flows are being transferred to local governments such as city-run hospitals, slaughterhouses and markets. To some extent, properties are obsolete, with zero or negative residual value.
- Real estate usually represents more than 80% of the total value of local government's assets.
- Most local governments have no documented and centralized inventory of their physical assets, much less a meaningful value of these assets and financial performance data
- Real property, plant and equipment are the most underutilized local resources.
- A clear understanding of assets and liabilities is precondition for moving forward intelligently with city financial management.

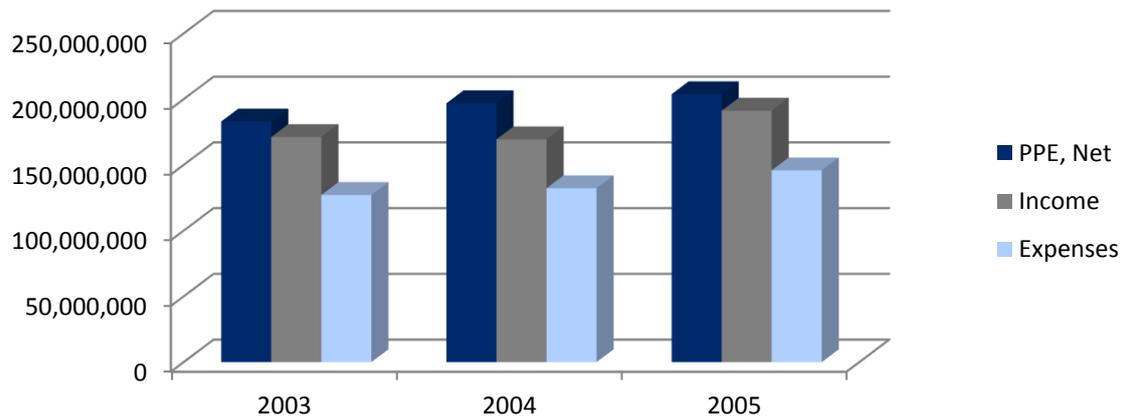
- While there is an established appropriate standards of accounting and reporting for real properties (property, plant and equipment). However, decisions regarding sale or retention, expenditure of capital funds for major renovations, rental rates, and financing options require valid information. Asset management require accurate data at the property level. Incomplete financial information at the property level, absence of market data (regarding competitive rental rates and sale values), and expense data not fully segregated by property will hinder effective asset management and will result in the failure of the portfolio to meet the financial and social needs and expectations of local people to whom the property belong.

In the ADB study, the following situation in the local government drive the need for Asset Management in the Philippines.

Decentralization challenges. Local Government Code provided for the decentralization of powers, authority, responsibilities and resources from the national government to the local governments. Certain basic services were devolved but the revenues earned from the taxing powers endowed were not commensurate. Despite of more than 2 decades of decentralization, LGUs, especially cities, remained heavily dependent on the national transfers to deliver the services required under devolution. The challenge is how to address the increasing number of services with limited financial resources.

High Asset Value. In the balance sheets of the LGUs, assets reflect greater value compared with their annual budgeted income or expenditure. As indicated in the Table 1, in the years 2003, 2004 and 2005 the Plant, Property and Equipment assets of local governments constantly surpassed their income and expenditures. This shows the potential contribution of asset management to LGUs towards increasing revenue, enhancing service delivery and transforming local governments to become self-reliant.

Figure 3: Total Assets, Income and Expenses over Time

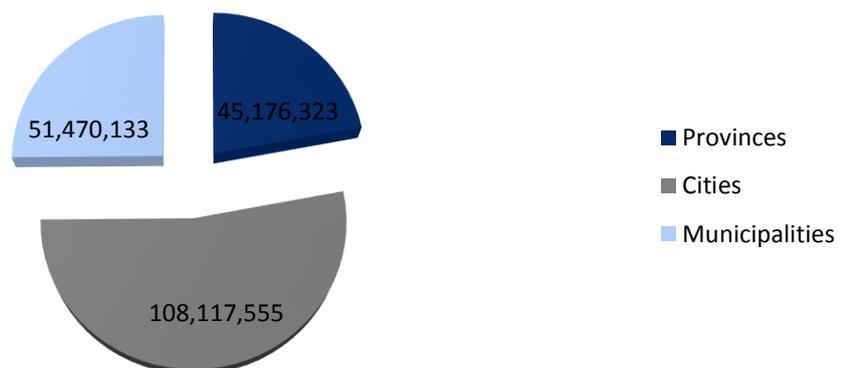


Source: Local Asset Management in the Philippines Final Report. Asian Development Bank Study

High Asset Maintenance in terms of capital value and annual cost of upkeep. Low expenditures in asset may reflect or speak of the need to increase funds for maintenance. In view of spiraling cost of maintenance and the increasing prices of properties, careful management is required to ensure effective utilization and in the process, generate additional revenues and savings, and enhance delivery of services.

Local government units in the Philippines own a substantial amount of real property in very diverse types. Moreover, the magnitude of PPE (plant, property and equipment) is high in city government units compared to other tiers of the government (provinces and cities). This is shown in Table 3. In relation to this, there are opportunities to improve the management of city local government real property assets.

Figure 4. Selected Plant, Property and Equipment in All Local Government Units



Source: Local Asset Management in the Philippines Final Report. Asian Development Bank Study

Among the levels of local governments, the cities accounted for more than 50% of total selected Plant, Property & Equipment. This can be traced to the higher value of real estate in the cities plus their greater financial capability. The first class provinces and cities account for most of the selected Plant, Property and Equipment while the first class cities claim the majority.

Raising local taxes and fees is a politically delicate process, while improving local finance through better management of property assets is far less demanding and risky politically.

However, real property causes recurrent expenses and capital expenditures as well, and until the net financial results are known, local governments have no ground to judge whether real property – even a revenue-generating one – creates a net financial inflow or drain. The need to have a complete picture of how real property assets influence the financial standing of the local government is one of the key reasons for introducing contemporary asset management

Possible outcomes of the current situation with local government property include both opportunities and threats for the local governments. On one hand, there are

opportunities for improving the local financial standing and service delivery and facilitating local economic development. On the other hand, there is a significant risk that:

1. The attention of the local government will be diverted away from providing core services, with its attention to management of its largest asset portfolio;
2. Local government would dominate the rental market, which could lead to market distortion and unfair competition with the private sector; and
3. Local government will be exposed to either real or perceived corruption or the related loss of confidence in the local officials responsible for the portfolio.

International Experience

Provision of Services: Public vs Private



In a practical sense, certain services can only be provided by government or under government control. These include national defense, roads, and the monetary system. Other functions can be provided by private entities or by government. What are the advantages and disadvantages of government providing those services also offered by the private sector?

Regarding governmental asset management, a clear trend in developed countries is toward privatization of many property assets and/or property-related services that in the past were delivered, owned and managed by governments. This trend covers a wide range of properties and services – from provision of office buildings for governmental agencies or infrastructure facilities to management of public parks, and is consistent at all levels of government.

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

I.5. Objectives and Scope of Asset (Real Property) Management

OBJECTIVES OF ASSET MANAGEMENT IN THE LOCAL GOVERNMENT IN THE PHILIPPINES¹²¹²

According to the *Local Asset Management in the Philippines Final Report* of the Asian Development Bank, the local governments in the Philippines should implement an efficient Asset Management system in order to:

- Improve the delivery of mandated services – this is achieved by rationalized allocation of office space for the department charged with the delivery of services. Likewise, cost effective maintenance and well-designed premises should inspire public service orientation among officials and staff.
- Increase revenue generation – the analysis and monitoring of income performance of public enterprises and the rental or sale of idle and non-performing assets should shore up revenues.
- Enhance LGU management processes – this can be achieved through the integration of asset management planning into other city government strategic and sectoral plans.
- Rationalize operating costs – this is attained through intensive analysis of operating costs and the observance of procurement guidelines of city governments,
- Attain efficient utilization of assets – the rationalized space allocation and asset use should lead to efficient utilization of assets.

In order to attain the above-mentioned goals and outcomes, local government must be able to stretch its corporate and regulatory functions to align with the global trends in the property sector. First, local government should transform its role as direct provider of real estate to an enabler of private sector to supply real estates. Second, consider treating real property as

¹² Local Asset Management in the Philippines Final Report. Asian Development Bank Study

productive resources rather than mere public goods. Finally, adopt tested and practical efficiency-oriented management practices and operations.

Furthermore, assets can be categorized according to their support to housing, physical and urban planning, communal services, childcare, social care, primary health care, primary education, culture, physical culture and sports, consumer protection, protection and improvement of the natural environment, and fire and civil protection. In terms of the level of priority, assets are utilized for:

1. Mandated services - responsibility of local government, as stipulated by law,
2. Social and cultural services – these are often discretionally, voluntarily supported and performed for social, political or other reasons, and Income generating (surplus).

Idle properties can also be categorized under those properties not used and not utilized.

SCOPE OF ASSET (REAL PROPERTY) MANAGEMENT IN THE LOCAL GOVERNMENT IN THE PHILIPPINES

Contents of real property portfolios in Philippines

The Local Government Code stipulates particular functions of local governments. Property portfolios must contain properties to accomplish the functions of government as indicated under this law. Therefore, property portfolios in Philippines are diverse and often include many of the following components:

- Land (common-use, vacant and suitable for construction, agricultural, other)
- Residential (social apartments, non-social apartments, other)
- Government centers (operational office buildings and premises for governmental and semi-governmental use)
- Non-residential (business) rentals
- Education, sports, tourism and cultural facilities (museums, pre-schools, state universities, libraries, theaters, parks, multi-purpose centers, movie theaters, other)
- Public markets, hospitals, terminals, slaughterhouses and other public economic enterprises
- Electrical, rural water works, public lighting infrastructure

- Economic zones, industrial estate parks, commercial buildings and warehouse/distribution real estate
- Enterprises: utility enterprises (gas supply, water, sewer), core urban service enterprises (cemeteries, landscaping, cleaning), business enterprises, other
- Ship and Aircrafts.
- Specialist Military Equipment.
- Office Equipment, Furniture and Fixtures
- Oil Rigs
- Roads
- Machineries
- Other property

Similar to the ADB Study, assets under Construction in Progress, which obviously are not yet usable, will not be the focus of this manual. Moreover, Leasehold Improvements and Other Plant, Property and Equipment, due to the minimal amounts reflected in the balance sheets have to be similarly excluded. Except for a handful of them located in highly urbanized cities, barangays do not earn significant revenues to allow the procurement of sizable Plant, Property & Equipment (PPE) assets.

I.6 Asset (Real Property) Management Model for City Local Governments¹³

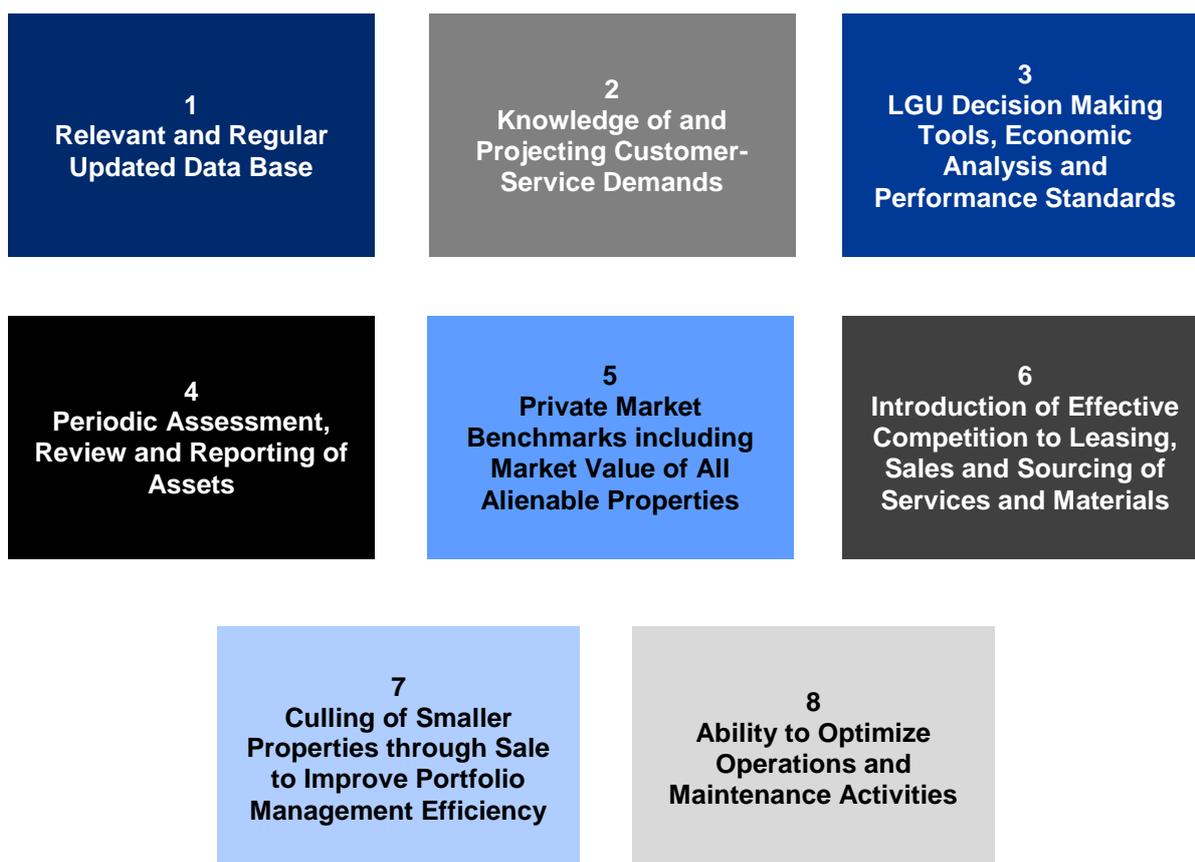
Asset Management. The asset management model introduces a new systematic approach to increase the effective use of real property, owned or operated by a local government. The first step is to create a comprehensive inventory of all assets, followed by an evaluation of each property to determine the best use for a local government. Upon completion of these steps, the model addresses other property management issues by introducing methodologies related to property valuation, analysis of direct and indirect subsidies, introduction of operating statements for each property, and so on. By using a multidisciplinary approach to managing assets, the model results in improving local finances, service delivery and facilitates local economic development.

¹³ Source: Local Asset Management in the Philippines Final Report. Asian Development Bank Study Asset Management Manual for Local Government Reform Project

Elements of Asset Management Practices¹⁴

A well-developed city real property asset management model should help local governments clarify and define the contents of their real property portfolios, as well as to monitor and control their functional and financial performance. City governments will be able to manage their property assets effectively and efficiently only if they adopt key elements of asset management practices in Figure 2.

Figure 2. Elements of Asset Management Practices



- **Element 1.** *Relevant and regularly updated databases on physical, operational and financial characteristics and condition of properties*

¹⁴ Source: Local Asset Management in the Philippines Final Report. Asian Development Bank Study Asset Management Manual, The Local Government Reform Project, Croatia, 2003.

In many instances the actual physical condition of the land, building, plant and equipment is not regularly assessed in any consistent, Strategic and methodical manner. Since ownership may be in dispute or inventory records are not adequately kept, the condition of the assets may be neglected over time. As the buildings and other equipment deteriorate or fall into disuse, the maintenance is neglected and very soon their condition is beyond reasonable economic repair. An inventory system with clear registration of ownership that includes some physical condition assessment over the life cycle of the asset is the main requirement to implement this best practice.

Plant and equipment assets, need to have performance and reliability records reflecting the usage and hours of operation, the requirements for maintenance of the assets other than normal maintenance requirements, the periods of inoperability and downtime as a percentage of the total operating hours to enable the assets to be effectively utilized. This information is vital in order that replacement decisions of the asset may be made and to gauge the cost/benefits of the asset to the service delivery requirements for which the asset was acquired.

The database should also indicate information on asset utilization and capacity. This is to determine if the land and building areas are being utilized to the fullest extent of their space. There may be periods in which the property is not utilized fully that can be used more or alternative uses can be employed to get more value from the asset. With regard to plant and equipment, there is a need to identify idle periods of use, the percent of usage as opposed to the total capacity utilization that the plant or equipment is designed and capable of achieving. The maintenance of this information should also incorporate the operational costs in utilizing the plant and equipment to see if additional usage would lower the average operational costs of the asset.

With the information and data available on the physical condition and the performance of the assets, some reasonable predictions can be made with regard to the possible failure conditions that might affect the use of the asset. There are a number of possibilities for the failure of the asset depending on the characteristics of the asset. Land and buildings are less subject to the types of failure normally associated with these. However, buildings and other physical infrastructure, such as bridges, water and sanitation pipes can experience structural failures and may not be discovered if not properly and regularly inspected. This is one failure mode that may be recognized over the course of time and use of the asset. Other examples of failure can be the situation where the plant and

equipment become obsolete and need replacement with more modern equipment. The use of the equipment may not be economically viable if the operation and maintenance of the asset is no longer acceptable. This might be the case with certain types of plant and equipment that cannot meet environmental pollution standards and the cost of the fuel for these plants and equipment has become very expensive.

Once the potential for failure is recognized there is a need to examine the possible options and alternatives to either mitigate the failure or to examine new options that will avoid the failure situation. There may be a need to recognize the need for complete replacement, repair or rehabilitation of the asset based on economic analysis, and the possible decommissioning of the asset due to it no longer providing the service required.

- **Element 2.** *Knowledge of Levels of Service Required by Customers and Predicting Future Demands for Service*

This represents the starting point for defining the assets that a local government unit must acquire and maintain over a life cycle of operations and service delivery. This knowledge of levels of service arises from the development of the strategic goals for the local government unit and should incorporate the inputs and participation of citizens in the development of the strategic plan and then the operational plan that will reflect the required assets to meet the service delivery requirements.

As a follow up to the requirement to know the levels of service required by the citizen/customers, there is a need to predict the changes in the conditions and requirements of services. This involves an estimation of potential new service delivery needs and mandates from the higher levels of government, changes in the demographic and geographical character of the local government unit, and the plans for economic development and the need for infrastructure to support new industries and services of the private sector. This prediction of future demands from services normally comes from the development of the strategic plan of the local government unit and the master plan that defines and describes the future physical changes in the local government.

It is also important to consider the demand-supply chain for services underpinned on demography, percentage increase in investments over time. This can strengthen the linkage of this process to existing planning processes of local governments such as the Comprehensive Land Use Plan (CLUP) or Comprehensive Development Plan (CDP).

- **Element 3.** *LGU decision-making tools and economic analysis related to management, accounting, budgeting, and operations. Including performance standards in the real estate market (such as return on investment and capitalization rate calculations).*

The LGUs should be equipped with a number of decision making tools to assist them in analyzing and deciding asset management, acquisition and disposal.

The acquisition and implementation of new assets, based on the need to replace existing assets, must be guided by thorough economic and financial analysis. The fixed and variable costs associated with the acquisition of assets, the operating and maintenance costs, and the impacts on the cash flows of the organization must also be considered. Each possible option or alternative must be assessed against the economic consequences on the financial condition of the organization to determine if it is a viable financial option. Many options may be economically advantageous. However, if the organization is unable to finance the operation and maintenance of the asset, it is not a viable financial alternative. Consequently, the ranking of options is based on both economic and financial conditions and the options prioritized based on these assessments.

There may be several possible options based on the rankings and many may be equally acceptable. The final determination is based on the option that has the least consequences on the use of the available financial resources within the budget constraints and cash flow consequences. This assessment will ensure that the acquisition and operation of the asset will have positive impacts over the life cycle operation and use of the asset on the organization and its ability to deliver the services required.

- **Element 4.** *Periodic Assessment, Review and Reporting of Assets.*

Every asset has to be evaluated based on its impact on the strategic objectives of the organization and the meeting of the service delivery requirements it is intended to provide. These strategic objectives and service delivery requirements, however, may change over time, hence the asset must be reassessed to see if it is continuing to contribute to new and changing strategic objectives and service delivery. It is important that performance measures, capacity utilization and other measures be identified and monitored over the life cycle of the asset to see if it is meeting the standards established for its operation.

- **Element 5.** *Private market benchmarks, including market value of all alienable properties*

A benchmark in terms of assets can be used to serve as point of reference or index to analyze or measure the performance and value investments through direct comparison or opportunity cost.

- **Element 6.** *Introduction of effective competition to leasing, sales, and sourcing of services and materials.*

This activity also involves a thorough study of the existing rates in the market, the supply and demand and how to rationalize the out-sourcing of services, including the materials needed.

- **Element 7.** *Culling of smaller properties through sale to improve portfolio management efficiency.*

This activity includes the identification of properties which can neither be consolidated to minimize overhead costs nor economical to manage compared to other properties. Depending on the size of the portfolio and unit managing the portfolio, culling or pruning of smaller properties can be done through sale to optimize productivity and efficiency.

- **Element 8.** *Ability to Optimize Usefulness of Assets*

This activity includes the process of increasing the value and economic benefit of the asset within their expected life cycle

- **Element 9.** *Ability to do Maintenance Activities*

Assets will have longer life than expected life cycle and efficient operation if their operating and maintenance costs are monitored and the appropriate repairs and parts replacements are regularly performed. This is one essential task of the management and asset operators to ensure that these operations and maintenance activities have a high priority of effort over the life of the asset.

These nine elements of asset management practices provide a checklist by which local government units can review and assess their own asset management practices. It is

important to consider that Local governments will be at various stages of development in their asset management process and may not necessarily be at a stage in which all of these will apply. However, over time and continued development of their asset management program, they should be able to incorporate all nine of these best practices into their strategic asset management program

Principal Actions

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

- **Assign/create structures within the local government unit dedicated to asset management.**

The structures described in this section may either be a separate structure, perhaps an office or embedded within an existing units, office or department with additional management task under the city government. Furthermore, city governments are encouraged to adopt their existing structures or innovate mechanisms that best suit or respond to their existing government operations. Described below are examples that serve as a guide, and are not in anyway prescriptive.

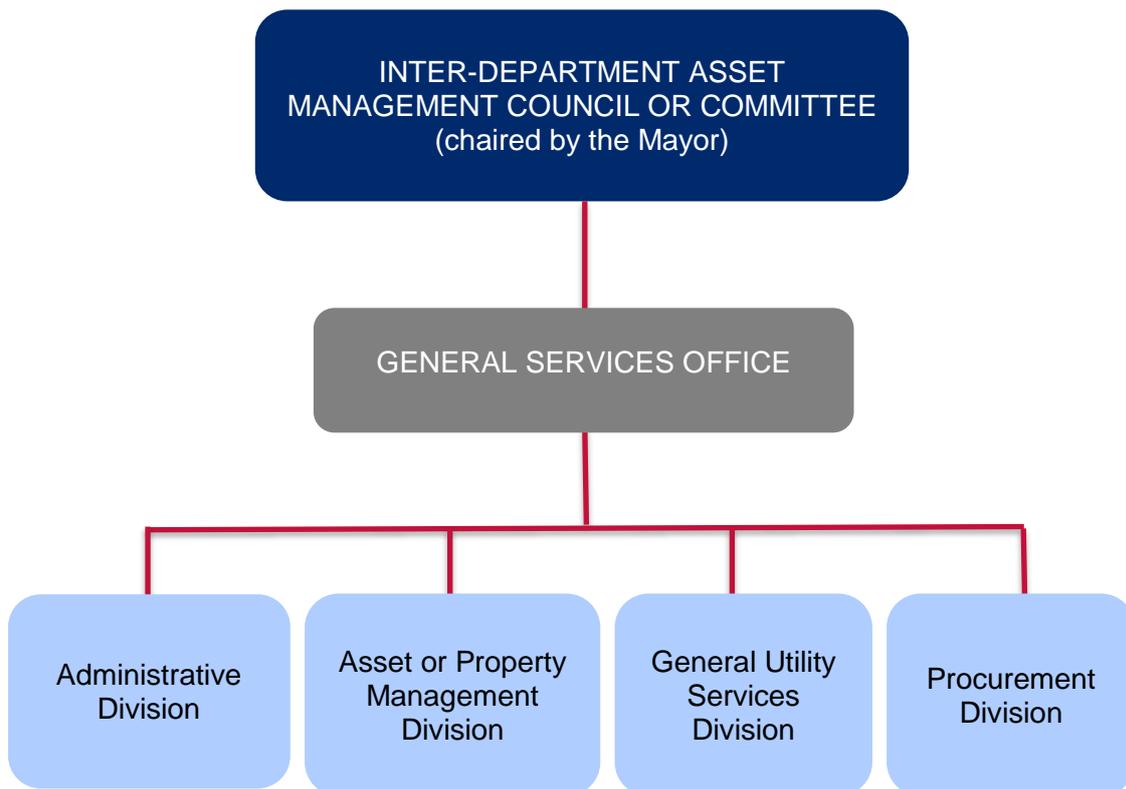
- a. *Inter-Department/Inter-Agency Structure.* The Local Finance Committee can be expanded (in terms of composition and functions) to serve as a policy making or oversight committee for asset management. This committee is composed of Sanguniang Panlungsod Member, Planning and Development Office, Economic Enterprise Development and Management Office, or Local Economic and Investment Promotion Office, Treasurer's Office, Assessor's Office, General Services Office, Legal Office, Internal Audit, Accounting Office, and Private Sector Representative. These offices were selected based on their functions related to asset management. Another option is to create an inter-department asset management council or committee which is composed of the same departments and offices. The Mayor, can serve as the Chairperson of the said committee. The City General Services Offices, can serve as the Secretariat of the Committee.

Key functions include:

- Formulate and oversee the implementation of policies related to asset management.
- Formulate and submit for SP approval the asset management plan.
- Monitor the implementation of the asset management plan.

b. *Operational/Implementing Structure.* Initially, the city government will expand/strengthen the City General Services Offices to anchor asset management taking into consideration the effective asset management principles.

Figure 3: Proposed Structure for the Asset Management



Key functions of the Asset Management Office:

- Serves as the over-all asset manager
- Manage the implementation of policies related to asset management.
- Operationalize the asset management strategies and program.
- Serve as repository of asset database.
- Monitor asset performance and by planning and executing long-term strategies.

- **Formulate the strategic directions on real property asset management in attaining the city government goals.** The process must be conducted at the local level with thorough multi-stakeholder debate, consultation and consensus. Goals may include providing mandatory services as efficiently as possible, generating revenue to fund local government functions, improving the cultural life of the city, improving the physical appearance of the city, or reducing the subsidies to non-government organizations and social users of assets. Other goals may be identified as well.
- **Classify properties according to their relation to city local government functions.** Financial policy, responsibilities, and the “hold or dispose” decision of the local government regarding each particular property should depend substantially on why the property is needed and how it is used. Whether a building is used for a core function such as housing the city government itself, or for a social function like showing movies, will influence further asset management approaches and decisions.
- **Build a property database.** The asset management process is dependent on accurate and thorough data. Some of this data, such as addresses and physical characteristics, will rarely change. Other data, such as financial performance and occupancy, will change constantly. Tools such as Geographic Information system or open-source software may be utilized.
- **Implement portfolio management practices.** Once goals have been established and an organization is formed, asset management practices must be implemented. Asset managers must focus broadly on achieving the goals set forth by monitoring daily and monthly asset performance and by planning and executing long-term strategies. It is important that the asset management department establish objectives, plans to achieve those objectives, and monitor progress toward such achievement.

The asset management model proposed in this manual consists of the following activities:

- 1. Introduction of a database/inventory system for local government real property assets.**

An accurate database system of city local government assets is a priority in establishing an effective asset management system as it will: (a) allow them to monitor and analyze real property assets and portfolios, and to develop and implement a strategic plan for

managing various types of city assets; (b) improve local government accountability and transparency in property dealings; (c) improve and intensify property use, reduce property related spending and increase revenues; and (d) offset the initial costs of creating the inventory.

The inventory should include two separate types of information: (a) actual inventory of assets; and (b) the inventory must include, on a property by property basis, financial and accounting data. Subsections of the inventory and accounting sections should also include property identification and accounting and financial data (which may include ownership status, size, current use, best use, justified utilization, revenues, expenses, appraised/book values) and liens on each property.

2. Restitution

Refers to the restoration of real property that have been lost or stolen to its proper owner.

3. Property classification and financial policies regarding the classification

Property classification refers to classifying LGU assets consistent with their function, i.e., delivery of mandated services, social and cultural services, income generation in order that specific goals and strategies can be defined for each function. This includes classifying assets as idle or unutilized for those properties that are not being used. Below are simple guides to determine properties according to function and objectives.

Assets utilized (city halls, schools, hospitals, etc.) for delivery of mandated services may be assigned the following objectives: (a) Increase the efficient use of facilities by requiring local government departments to justify their demand for space; (b) Minimize operating costs – Analysis of operating costs per department or per occupant on a per-square meter basis is a good tool to minimize operating costs; (c) Locate government offices and services in functional and accessible not prime areas and in modest buildings and facilities. Modest and designed-for-efficiency buildings in accessible areas will be desirable; and (d) Understand the best use of an asset and make cost benefit analysis to justify the governmental use of a particular asset – put assets to their best use to realize the most benefits from them.

Assets utilized for social/cultural services (parks, plazas, monuments) may have the following goals:

- a. Analyze actual costs in order to facilitate best decisions costs of operating the assets and maintaining it have to be analyzed and compared with other similar assets to guide decisions on whether to spend on maintenance and reduce operating expenditures;
- b. Generate program alternatives to reduce direct and indirect property-related subsidies as much as possible to generate savings by having users of their sponsors maintain the property themselves and encouraging users or their sponsors to lease the unused portions of the premises to other commercial or non-profit entities, accurately account for resulting net revenues and adjust subsidies;
- c. Establish clear contractual relations with users which stipulate mutual responsibilities for property maintenance and allocation of costs and revenues; d) Monitor usage and occupancy to assure that unused space is reassigned to more serious users; e) Arrange for sharing facilities by multiple groups.

Assets utilized for income generation may have the following objectives:

- a. Lease out properties at their highest and best use to generate the required revenues – renting out properties for their best use in the locality will generate higher rates
- b. Periodically evaluate income-generating performance of public enterprise properties using alternative investment benchmarks - financial analysis will give a fair picture of performance of income generating properties
- c. Make selective capital improvements to enhance production – only necessary improvements calculated to improve production shall be undertaken
- d. Sell under-performing properties to generate one-time revenues that can be put into better use; e) Reduce maintenance costs

For idle properties, determining the best use, developing and operating or renting it is suggested. Those assets, which cannot be developed, operated or rented, should be sold to raise funds in the treasury for improved delivery of services.

4. Real estate and business appraisals

The assets for which appraisal is necessary are those utilized for income generation. For these properties, knowing the market value is critical to monitoring and controlling performance. As part of the real property asset management process, the financial performance of each particular property is evaluated against the fair market value of the property. The other alienable assets, such as city/city halls and capitol premises need to be appraised periodically, perhaps five years, to monitor value and provide guidance when there is an alternative to relocate to less prime areas.

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

Contemporary property valuation practice relies on three methods of appraisal or approaches: the cost approach, the sales comparison approach and the income capitalization approach. These approaches will be explained in detail in Chapter II, Activity 4 of this document.

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

6. Intensive financial analysis of portfolios, properties, and projects

7. De-regulation of business rentals and improvements of rental practices

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

9. Reporting on property

10. Management Consolidation

11. Developing a Strategic Asset Management Plan

Practical Application

I.4.1. Asset Management Activities



Beginning in 2001, other local government units in other countries began implementing many of the activities listed above. Examples and outcomes from the initiatives are described throughout the manual to illustrate how the Asset Management Model can work in Philippines.

II. ACTIVITIES FOR EFFECTIVE ASSET MANAGEMENT

Activity 1: Introduction of a new Database/Inventory System for Individual Real Property Units

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Begin data collection according to Appendix 1, “Local Government Asset Inventory Guide”*
- *Start from the best and worst performing properties and portfolios. It is likely that this will be the portfolio of business rental properties, followed by other portfolios (such as rental apartments, for governmental use, sport facilities, etc.)*
- *Include a special section on real properties which cities do not own or control but support financially (such as cultural facilities)*
- *Either develop or adopt an existing computerized database for maintaining this information*

This chapter aimed at assisting local governments in gathering basic data on city real property necessary for prudent asset management.

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

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

- Responsible stewardship of public assets requires data collection and monitoring;

- In some cases, a legal obligation to collect data;
- As a precondition for city bond issues or insurance coverage; and
- Improves local government accountability and transparency in property dealings.

In short, an accurate inventory is necessary for effective asset management; improved asset management, by improving and intensifying property use, reducing property-related spending and increasing revenues.

The inventory should also include two separate types of information: (1) an actual inventory of assets and (2) financial and accounting data.

Subsections of the inventory and accounting sections should include:

Inventory

- property identification number (PIN)
- size
- characteristics
- current use
- use restrictions or functions
- potential use
- managing entity

Accounting

- tenant roster
- occupancy
- acquisition costs
- appraised, market and residual values
- insurance
- lease data, revenues/expenses, recorded on a regular basis
- value and financial liens against each property
- economic life

The information mentioned above should be collected on an entire real property, not on separate premises within the real property. (Appendix 1 contains a sample inventory format.)

Currently, most local governments are unable to track some categories of data on a property-by-property level. Especially complicated to track is the situation with expenses and revenues. Expenses particularly cannot always be identified for each real property unit as the traditional accounting and budgeting practice of local governments are not geared toward this task. For instance, it is quite common that entities within or even outside the local government (such as

the communal department, “line” departments, social tenants, and private property managers) receive lump sum funds from the local budget to cover various components of operating and maintenance costs for various groups of properties. As a result, operating and maintenance expenses for a particular property may be paid by more than one entity; at the same time, some of these paying entities may not track the specific property units on which they spent these funds. On the revenue side, there are cases when social tenants (for example, sport clubs using a local government stadium) generate revenues at the property while the owner has no data on this revenue and continues to subsidize the clubs by providing funds for stadium maintenance. In many instances, property-based revenue data can be extracted, but it requires a lot of effort.¹⁵

Practical Application II.1.1. Inventory Problems



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

It is important that the owner of the asset track the total revenues and expenses associated with each property. A property manager (in some cases, this may be a tenant) acting on behalf of the owner (local government) may collect all revenues and pay all expenses (including property management fees, when a manager is a specially hired entity). Whether the manager then remits the net profit (cash flow) to the owner or retains some part of it as a subsidy should be defined in a contract with this entity (this may happen, if the property is managed by a social tenant). Regardless, the manager should provide a complete accounting of all transactions for the relevant period. With that accounting, the owner has complete information regarding the performance of the property. The owner may incur other expenses associated with the property that are not paid by the manager, and that transaction data should be incorporated into the property manager’s report.

For some types of rental properties, it is customary for the tenant to pay all expenses and also pay a net rent to the owner; hence, it is less important for the owner to have all property expense data. For instance, in some western markets, it is typical to lease industrial buildings to tenants under a “net lease” providing for the tenant to pay all taxes, insurance, repairs,

¹⁵ The fact that current budget and accounting practices are insufficient for managing large local government property portfolios emphasizes the importance of clarifying the roles of asset and property managers. especially acute.

landscaping, and other expenses. The owner must be assured that taxes and insurance costs are paid and that the property is well maintained, but the actual expenses for such work are not recorded by the owner.

In a competitive market, the tenant pays a fixed amount for occupancy (including all costs). Financially, it is not important whether a gross rent is paid to the owner and the owner pays the costs of operating the property, or a net rent is paid to the owner and all operating expenses are paid by the tenant. In either case, the total cost to the tenant (and net revenue to the owner) is the same. However, it may be more convenient for the tenant to assume responsibility for paying costs so the work can be contracted and supervised by the tenant who is present at the property. The tenant also may be capable of doing certain work at a lower cost than what an owner would pay to a contractor.

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

Practical Application II.1.2.
Inventory Issues



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

In an attempt of one LGU to complete its inventory of about 230 business properties (including about 140 properties in the process of restitution). Over the period of one year, more than 740 property units were recorded. The simple act of assembling this information has led to important discoveries, including the current underutilization of certain assets, assets that generate very low cash flows, allocation of prime space to NGOs paying little or no rent and rarely using the space, and other circumstances that offer early and relatively easy opportunities for improving the financial performance of the portfolio. Further study will reveal additional opportunities for improvement.

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

should be avoided to the maximum extent possible. Building up deferred maintenance should stimulate some radical decisions, such as disposal of properties that the local government cannot properly maintain, reducing property-related subsidies to tenants, revising local budget priorities, and so on.

DEFERRED MAINTENANCE

Needed maintenance (repairs) - Actual maintenance = Deferred maintenance

Deferred maintenance causes:

- Threat of early dilapidation and deterioration
- Unwillingness of prospective tenants to lease and pay high rent
- Decline in value

A regular property inspection to monitor maintenance is an important part of the asset manager's tasks. While underinvestment may be indicated by financial information, the true test lies in the physical inspection of the property. The inspection must focus on elements subject to change since the previous inspection, such as the roof and mechanical systems. Critical thinking is also important in terms of other aspects of asset management so that maintenance is driven by practical need rather than irrelevant formula.

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

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

An important practical question for many local governments is where to start implementing the new system of data collection and maintenance. Though most local governments have a

variety of portfolios, larger income-generating (rental) properties appear to be the most rational starting point.¹⁶

Activity 2: Transitional Issues

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Prepare a list of properties for restitution - identify a separate list of properties for which the local government does not have clear ownership rights*
- *Develop and approve a policy minimizing further local government investments in properties that it does not own or control*
- *Annually review budgeted expenses for such properties, on a property-by-property basis*
- *Assure consistency between property rights and the balance sheet (ensure that the asset management property records and the records on the balance sheet match up)*

In the Philippines, there are several transitional processes that require the attention of local governments. First, in vertical scope, ownership of the assets is being redistributed among local governments. Second, in horizontal scope, following the territorial reform in the early nineties, many new local governments were created. One of the consequences is the need to consolidate balance sheets of these newly formed local governments. In particular, ownership of the assets needs to be cleared. Finally, through restitution processes, property rights are being restored, of those property owners, from whom the real estate was confiscated, particularly those properties confiscated during the martial law years.

Practical concerns regarding these changes of ownership must be addressed. If properties to be removed from the local government's balance sheets are not producing income, perhaps the local government can take actions to expedite the transitional process. A key asset management question is whether the local government wants to invest -- and how much -- in maintenance and repair of real properties that would likely be restituted or otherwise removed from its portfolios. In particular: does the local government want to invest equally in its own

¹⁶ Technical issues of the database are not explicitly discussed in this manual. The manual also does not cover city movable property, such as automobiles. Ideally, the data collected in accordance with the suggestions above will eventually form only one component of a larger local government property inventory (of both moveable and immovable property).

and properties that would be removed from its portfolios or, instead, will it provide some preferences to its own real property? The same questions are applicable to other properties that the local government does not own but supports financially (such as properties of independent cultural institutions): should the local government invest in them with the same intensity as in its own real property?

It is also important to remember that transfer or disposition of assets will require removal from the LGU balance sheet as well as corresponding policy enactment.

Every government budget is limited, and choices must be made. Logically, one would assume that priority would be given to properties that the city will own for the foreseeable future or to properties that will be sold and for which the sale price will be significantly and demonstrably increased by making certain repairs. However, officials may responsibly determine that the community would benefit from the restituted properties being delivered in excellent condition with the expectation that good maintenance would continue. Also, the deterioration of cultural properties may reflect poorly on the image of the city, regardless of the ownership. Local circumstances will determine the outcome of this decision-making process, but the bias should be toward concentrating the city's limited resources on those properties for which the city stands to benefit directly rather than those for which the benefit is indirect and unquantifiable. In each case, a careful objective financial analysis should be made to determine the financial benefit of any significant expenditure.

Practical Application II.2.1.
Investment Policy



A city government has identified approximately 140 properties that are in various stages of the restitution process. As a result, the policy decision not to make capital improvements to these properties and to carefully monitor and control recurring expenses was made.

These questions are far from being purely financial — they are directly related to the overall policy of the local government. However, policymakers need objective information in order to make sound decisions and choices. This is why it would be useful, within the new database on local government property, to identify and mark properties that are likely to be removed from its portfolios. Also, the local government needs to trace all its expenses for properties that it does not own or control. Information about expenses and revenues associated with these groups of properties may provide useful insights for decision-makers.

Financial data is also critical when improvements are being considered; a partial budgeting process is particularly helpful. This involves an analysis of the *changes* in income and/or

expenses resulting strictly from an expenditure, and then comparing those changes to the amount of the expenditure. For instance, a new air conditioning system (improvement) may justify higher rent (income), due to improved comfort to the occupants or lower costs due to improved efficiency of the system. Or, if an improved air conditioning system is considered for a government-use building, the money saved in future operating costs could easily recover the investment over a few years; this also justifies the investment. It is also possible that income and expenses could increase. If income increases more than expenses, cash flow will also increase; this is another way to justify an investment.

Things to think about:



- > What are the challenges and obstacles in transitional process concerning ownership and management of the assets?
- > How do the transitional processes involve and affect local government?
- > What are the means available to Local Governments to manage transitional issues?
- > What kind of information do decision makers need to make good decisions on transitional issues?

Activity 3: Property Classification

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Draft classification of all properties into three groups: properties for delivery of mandated services, social and cultural services, and income generating (surplus). A fourth classification may be added – idle or unutilized.*
- *Formulate financial principles and goals for each group of property*
- *Introduce standards for “property consumption” for those entities receiving subsidies or support from the local government*
- *Approve the classification and financial principles/goals at the Local Government Council as a part of the **Strategic Asset Management Plan***

PROPERTY CLASSIFICATION: MANDATORY, DISCRETIONARY, AND INCOME GENERATING (SURPLUS) PROPERTIES

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

In the private sector, the goal of property owners is to maximize value. Returns on investment are optimized in relation to risks (political, economic and transaction risks). The general trend in developed countries is for local governments to adopt many concepts and methods of property asset management used by the private sector.

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

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

Local government functions now include management of settlements and housing, physical and urban planning, communal services, child care, social care, primary health care, primary education, culture, physical culture and sports, consumer protection, protection and improvement of the natural environment, and fire and civil protection. According to these functions, properties needed to support these functions can be sorted in four groups:

1. Assets utilized for mandated services - responsibility of local government, as stipulated by law;
2. Assets utilized for social and cultural services – these are often discretionally, voluntarily supported and performed for social, political or other reasons;
3. Asset utilized for income generating (surplus); and
4. Idle Properties.

INTRODUCE STANDARDS FOR “PROPERTY CONSUMPTION” FOR THOSE AGENCIES RECEIVING SUBSIDY OR SUPPORT FROM THE LOCAL GOVERNMENT

Local governments provide both mandatory and voluntary support to organizations. Legislation clearly defines some functions as exclusively or shared responsibilities of local governments, and accordingly, also defines mandatory local government facilities. These facilities include preschools, social housing, water/sewer infrastructure, cemeteries, sport facilities, theaters, museums, libraries, parks, and some others.

However, a key issue that was not addressed by the law is on how many facilities the local government is required to support. While the LGC specifies functions of the local governments, specific standards of property consumption are not defined nor does it have by-laws. The local government may have the discretion in making decisions and introducing some standards of “property consumption” that the local government subsidizes or supports from its budget.

International Experience Classification Process in the City of Varaždin, Croatia



The Administrative Departments in Varaždin (local government in Croatia where asset management took hold through the introduction of asset management practices detailed in this manual) completed a preliminary classification and presented it to the City Council and Government in February 2002. Based on the debate that followed, the classification was revised, and asset management decisions are now made with realistic objectives for the acquisition, use, and disposal of assets within the property portfolio.

FORMULATE FINANCIAL PRINCIPLES AND GOALS FOR EACH GROUP OF PROPERTY

Use of properties for mandatory functions should be optimized by:

1. increasing the efficient use of facilities, by requiring governmental departments to justify demand for their space;
2. minimizing operating costs;
3. locating government offices and services in functional, not prime areas, and in modest buildings and facilities; and
4. understanding the best use of an asset and making cost-benefit analyses to justify the governmental use of particular properties.

ASSETS FOR DISCRETIONARY FUNCTIONS SHOULD BE OPTIMIZED BY:

1. analyzing actual costs in order to facilitate the best decisions
2. generating program alternatives to reduce direct and indirect property-related subsidies as much as possible (also see Activity 8); particular suggestions include:
 - have users or their sponsors maintain the property themselves,
 - encourage users or sponsors to lease unused portions of premises or territory to other commercial or non-profit entities, accurately account to owner for resulting net revenues, and adjust subsidies appropriately,
 - establish clear contractual relations with the users, which stipulate mutual responsibilities for property maintenance and allocation of the costs and revenues,
 - monitor usage and occupancy to assure that unused space is reassigned to more serious users,
 - arrange sharing of facilities by multiple groups.

International Experience Identifying Under-Performing Rental Properties in Varaždin, Croatia



After asset managers in Varaždin, Croatia, identified all properties subject to restitution claims and completed property classification, they identified approximately 70 surplus properties currently owed by the city as income-generating rentals. They then estimated the value of each of these surplus properties and compared that value to the net income produced by the respective property. They immediately found many properties that had income far below a minimum threshold of 5%, which indicated that the market placed a higher value on the asset than was supported by income.

In this case, the asset manager must first review the asset to see if income could be significantly increased as suggested by the higher market value. If not, the asset should be sold because the sale proceeds could be reinvested at a higher return than the return from owning the asset. To conduct this analysis, value estimates must be made and income and expense data must be available. The results of the analysis are only as good as the quality of the estimates and data used.

The results of this analysis in Varaždin were many. Two examples are the improvement of leasing practices and instituting competitive bidding procedures for subcontractors to sports facilities.

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

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

1. Leasing property at its highest and best use, to generate recurrent revenues;
2. Periodically evaluating income-generating performance of these properties using alternative investment benchmarks;
3. Making selective capital improvements to enhance income production;
4. Selling under-performing properties to generate one-time revenues that can be put to better use; and
5. Reducing maintenance costs and liability on the property if it cannot be leased or sold.

Practical Application II.3
Classification of Revenues from the Disposal of Surplus Property



During the first half of 2003, City government sold parcels of land (each between 500 and 800 square meters) for individual housing units, for the socially subsidized housing program and for business purposes. This capital sale produced about 11.851.100M pesos, or about 8.7% of the City's annual budget. It expects to generate up to 6 M pesos more from the same source by the end of 2003. Not only did the city simplify their portfolio by selling these properties, but the sales also generated positive relationships with private individuals who can pursue their private interests and dreams for meeting their own housing needs.

Reclassification of a Historic Property

The City reclassified a historic palace worth about Three Million pesos as surplus property, and will lease it in the free market. Starting rent will be 500,000 pesos annually, with a commitment of the future tenant to make appropriate capital improvements. This is an ideal example of a local government coming up with a creative way to generate supplemental revenue, based on their local context and resources.

APPROVE THE CLASSIFICATION AND FINANCIAL PRINCIPLES/GOALS AT THE LOCAL GOVERNMENT COUNCIL AS A PART OF THE STRATEGIC ASSET MANAGEMENT PLAN

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

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

International Experience
Enhancing Property Value: Public vs. Private Owner



A prominent western business consultant has observed that an investor should only own an investment asset if that investor is capable of uniquely adding value to the asset. If another investor can add more value, that investor can pay a higher price for the asset and should own it.

In western systems, it is generally observed that private enterprise, driven by the profit motive, is capable of adding greater value than are government and non-profit sectors. For this reason, assets and functions are evaluated for privatization. They have found ways to privatize social and even military housing, management and maintenance of mandatory property and functions such as City Hall, street repair, garbage collection, water utilities, and prison operations.

By competitively and intelligently privatizing, assets are used more efficiently and functions are performed at lower cost.

Activity 4: Real Estate and Business Appraisals

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Identify all real properties that are (potentially) alienable; conduct systematic appraisal of their fair market values.*
- *Conduct pilot appraisals for several properties, selecting those, which appear to be either the most profitable or the most problematic and resource draining for the local governments; use these pilot appraisals to begin a systematic appraisal of all properties.*
- *Before any sale of local government property, order an independent appraisal*
- *Develop appraisal expertise among asset managers so that they can act as “educated clients” for professional appraisers*
- *Consider appraisals of life-cycle costs for non-alienable properties*

- *Consider appraisals of the local government's business interests in various enterprises*

REAL PROPERTY APPRAISAL

Based on the Asian Development Bank study, “the assets for which appraisal is necessary are those utilized for income generation. For these properties, knowing the market value is critical to monitoring and controlling performance. As part of the real property asset management process, the financial performance of each particular property is evaluated against the fair market value of the property. The other alienable assets, such as municipal/city halls and capitol premises need to be appraised periodically, perhaps five years, to monitor value and provide guidance when there is an alternative to relocate to less prime areas.

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

Contemporary property valuation practice relies on three methods of appraisal or approaches: the cost approach, the sales comparison approach and the income capitalization approach.”

1. Cost approach, based on estimates of the replacement cost. This approach adds the estimated construction cost to replace the building (including architectural and other “soft” costs) to the market value of the land. This approach often sets an upper limit on value because, if other approaches indicate a higher value, more property will be developed at the lower cost until equilibrium is reached. This approach is “based on the proposition that, an informed purchaser would pay no more for a property than the cost of producing a substitute property with the same utility as the subject property.”

The starting point of the cost approach is the assembly of property facts in an appraisal inventory and the accumulation of cost data in the price governing factors. These are combined in the cost estimating process to develop a reproduction cost new (RCN) or cost of replacement (COR). Reproduction Cost New (RCN) is the cost of producing or constructing the property in like kind at current prices using the same materials, construction or manufacturing standards, design layout, and quality of workmanship. Cost of Replacement (COR) is the cost of producing or constructing a property of equivalent

utility at current prices using modern materials according to modern standards, design and layout.

Inherent in the total RCN and COR are direct and indirect costs. The combination of these two cost components is a required consideration to appropriately reflect property in use. Direct costs are all element costs, which are directly incurred in the purchasing and placing of the property unit in use. Indirect costs are all element costs, which are incurred, but not directly assignable to the placing of the property unit in use.

2. Sales comparison or Market Data approach. This simply answers the question, “What have other similar properties produced as a sale price when offered in the open market?” This is a comparative approach in appraisal analysis based on the proposition that an informed purchaser would pay no more for a property than the cost of acquiring an existing property with the same utility.

The market approach is particularly applicable when there is an active market with sufficient quantities of reliable data, which are verifiable by authoritative sources. The market approach is relatively unreliable in an inactive market or in estimating the value of property wherein there is no true comparison.

As in the cost approach, the starting point of the market data approach is the assembly of property facts in the appraisal inventory and accumulation of market data in the form of current market sales and offerings. These are combined in the valuation process to develop an estimate of fair market value. Information obtained during the inspection of the property should include age, size location and other factors pertinent to a comparison with a property exchanging in the market. Analogous to the situation of the reproduction and replacement costs, the market analysis may be made on a direct or comparative basis.

Direct matching is the comparison of property with an identical or nearly identical property exchanging in the market.

Comparable matching is the comparison of a property with a similar property exchanging in the market.

Comparison is an estimation of two or more items to established similarities and dissimilarities of various attributes.

3. Income capitalization approach. In its simplest form, this approach uses the formula $\text{Value} = \text{Cash Flow} / \text{Required Rate of Return}$. According to BLGF Manual, the Income Approach is an estimate made of the prospective economic benefits of ownership. This approach is predicated on the proposition that an informed purchaser would pay no more for a property than the cost of obtaining an income stream of the same size and embodying the same risk as that involved in the subject property.

The income approach is particularly applicable when the future benefits of ownership may reasonably be estimated in the light of related risks to be incurred.

The approaches selected must be supported by the facts and circumstances of the case on hand. The applicability of any approach in a given valuation problem depends on the character of the problem, the type of the property involved, the nature of the market and, of course, the availability of the required data of appropriate quality and in sufficient quantity.

Reconciliation is the final step in estimating value. It is the process of relating the data gathered, developing the three standard approaches to value, analyzing and weighing the strengths and weaknesses of each approach, and determining which approach is best supported. Ultimately, the most relied upon approach will be the most defensible and best-supported approach. The other two approaches provide additional support.

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

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

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

- **Apartments and houses not rented:** Sales comparison approach is probably best. The Cost approach may be helpful, but for older properties it may require too great an adjustment for depreciation to be helpful.
- **Business rental property:** Income capitalization and sales comparison. Again, the cost approach may be useful for newer properties.

- **Vacant land:** Sales comparison is the only practical approach, because there is no income to capitalize and there is no construction.

Professional services

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

Practical Application II.4.1. Appraisal Practice In Philippines



Court experts are legally authorized for property appraisal in the Philippines. In spite of the general tendency to appraise property based on the replacement cost (the cost approach), many court experts are acquainted with and use other contemporary methods of property appraisal.

In Philippines there are groups such as the Association of Real Property Appraisers and Brokers (RPAB) and Philippine Association of Real Estate Brokers (PAREB), whose members are qualified to appraise both real property assets and enterprises. They are focused on income capitalization methods of property and business appraisal.

For legal purposes, appraisal by the court expert is the only acceptable solution. However, if an appraisal is needed for monitoring property performance rather than for legal transactions, the qualifications and skills of an appraiser are more important than his or her accreditation with the court.

Identification of the priority of properties to be appraised

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

1. Not all public properties have trade potential or private sector comparable sales.
2. Many assets have social worth that is difficult to quantify.
3. The value of public property depends on classification and restrictions.
4. Standards for valuing public property are difficult to introduce and support.

5. Valuation is an expensive process, especially when court experts prepare well-documented appraisal reports; therefore, the cost to the taxpayer is considerable.

Given the high costs, appraisal requires prudent decisions on how to proceed. It is essential to obtain an appraisal in a case involving legal proceedings, using real property as collateral (security) for a loan, and disposal of assets without open competition. For other cases, the cost of an appraisal might exceed expected benefits, and before proceeding, qualified asset managers should make the preliminary analysis (which may include an educated guess on the values of the properties that they manage) in order to identify properties where the appraisal is needed most urgently. This is an example of the need for intelligence and creativity in the mind of the asset manager.

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

It is easy to get distracted by terminology. Do “appraisers” provide “appraisals” and brokers or others not qualified as appraisers provide “valuations?” For now, such distinctions may be unproductive. The important issue is to identify the appropriately qualified individual for each assignment, all in the context of importance and cost.

Policy Requirement of Asset Management

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

The following may be elements of such a policy:

- Each asset must be assigned a value, either as determined by a qualified appraiser, by another independent individual experienced with such properties, or by an asset manager.
- Market value, not replacement cost, is the necessary conclusion.
- Priority for obtaining appraisals should be placed on larger properties and those under consideration for sale. The other properties in the portfolio should be appraised, or have values assigned, over the subsequent two to three years. Individual residential units, small vacant lots, and other assets of lesser perceived values may be assigned a lower priority for appraisal or valuation, but the asset manager may immediately assign a preliminary value based on experience.
- Consideration for selecting appraisers and others providing values include importance of the property in the portfolio, the significance of the valuation (for instance, a sale is more significant than simply maintaining a complete record of asset values), and cost of preparing the valuation. In some circumstances, a real estate broker or other person familiar with property values may be retained rather than a fully qualified appraiser, but such a person should have no present or anticipated future involvement with the property that would impair the independence of his or her judgment of value.
- The asset manager should review each valuation annually. If property or market circumstances have changed significantly, a new valuation should be obtained, either from an appraiser or another sufficiently qualified person.
- For every property, a new appraisal should be obtained at least every five years.
- For purposes of objectivity, the same appraiser should not be retained to repeatedly appraise the same property. However, an appraiser may be assigned other properties to appraise in subsequent years. Likewise, the same appraiser should not be retained to appraise all properties in the portfolio.
- Newly assigned appraisers should not be given the analysis of previous appraisers to review but should be required to perform their own analysis to maintain objectivity. However, all relevant facts about the property known to the asset manager should be given to the appraiser. These include architectural and engineering drawings, income and expense data, information regarding physical condition and defects, and similar information.
- An appraisal should be conducted by an independent appraiser or another professional with market valuation experience prior to any significant financial transaction such as

a sale, major lease, significant capital improvement, or financing (mortgage loan) and in the case of legal proceedings.

- Some properties may be of such low value that the cost of a formal appraisal would be disproportionate to its value, perhaps even exceeding its value. The asset manager must use sound judgment in determining those larger assets for which independent valuations are required and those less significant for which a valuation can be prepared by the internal asset management staff.
- It may be appropriate to obtain an independent appraisal or other independent valuation of a sample of small properties if the portfolio includes many similar small properties that, individually, would not justify the cost. The appraisal of a sample will provide guidance to the asset manager in assigning values to the other similar properties.
- A goal should be to remove the temptation by asset managers to inflate the value of their portfolio in a way that would reflect well on themselves and their personal importance.

WHICH APPRAISER WOULD YOU CHOOSE? (A LITTLE HUMOR!)

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

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

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

The third candidate, when asked, closes your office door, looks around to assure that no one else is in the room, and then quietly whispers, "What would you like the value to be?"

The practical steps toward the market valuation of local government real estate are indicated below. Furthermore, these steps can form part in the preparation of the **Strategic Asset Management Plan**.

- Develop a special database to contain data on sales of the local government's properties, which would allow keeping detailed information on local government's properties sold. This database should contain the address, size, use, physical characteristics and condition, date of sale, price, sale expenses, and sale circumstances for each sold property.
- Develop an overall approach to the process of valuation (in particular, to deciding which properties should be appraised first, how often re-appraisals should be done, etc.).
- Begin the systematic appropriation of budget funds for paying for the appraisal of local government-owned properties.

International Experience
Appraisal Practice in Croatia



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

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

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

Sample Property Appraisal

Here are some facts:

The City owns a building with a land site that had been used for a pre-school, but recently it had been closed because few children attended.

Property Details			
Land area:	500 m ²		
Building area:	2200 m ²		
Construction costs (according to engineers)	4,500 Pesos/m ²		
Expected life of new construction	50 years		
Effective age of building	10 years		
Information gathered in the market on other land sales			
Parcel	Size (M ²)	Sale Price	Comparison
A	1,500	2,250,000 Pesos	Better
B	3,000	3,000,000 Pesos	Similar
C	2,500	2,000,000 Pesos	Lower

Cost approach

What do we know so far? The land value can be estimated by calculating the prices of other land per square meter as follows:

Parcel	Pesos/M ²
A	1,500
B	1,000
C	800

Using the comparisons shown above (better, similar, lower), a fair estimate of the land value could be 1,000 Pesos/M² or 2,200,000 Pesos for the 2,200 M² site.

The cost of replacing the 500 M² building (4,500 Pesos/M²) is 2,250,000 Pesos. But it is ten years old. Assuming a fifty year expected life, a depreciation factor of twenty percent (P

450,000) must be deducted (ten years divided by fifty years = twenty percent). Thus, the value of the structure is P1,800,000.

So the cost approach indicates:

Land	2,200,000 Pesos
Building	1,800,000 Pesos
Total	4,000,000 Pesos

Additional facts:

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

Property	Building Size	Net Income Pesos/M²	Sale Price
I	400	1,200	4,000,000
II	300	1,350	3,520,000
III	600	1,150	5,100,000

Other facts

Market vacancy rate	%
Land availability	Scarce
Bond rate	4.2%
Price of chocolate in pesos	600.00Pesos/kg

Sales Comparison Approach

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

I	10,000 Pesos/M ²
II	11,733 Pesos/M ²
III	8,500 Pesos/M ²

With this data, it is reasonable to conclude that the subject property (the one being appraised) is worth **10,000 Pesos/M²**, or **5,000,000 Pesos** under the **sales comparison approach**.

Income Capitalization Approach

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

Comparable Property	Income Pesos/M ²	Value Pesos/M ²	% Return
I	1,200	10,000	12.0%
II	1,350	11,733	11.5%
III	1,150	8,500	13.5%

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

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

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

Here is a summary of the approaches:

Cost	4,000,000 Pesos
Comparable Sales	5,000,000 Pesos
Income Capitalization	4,800,000 Pesos

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

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

In this example, the cost approach was far below the other two approaches. Perhaps we underestimated the value of the land or construction costs, or overestimated the amount of

depreciation. Perhaps the comparable properties were not actually comparable. A great deal of thought and judgment is always required of the appraiser to reach a final conclusion.

Extensive information on appraisal is available from a variety of sources. In particular, the BLGF Appraisal Manual and its companion document on Mass Appraisal Guidebook should be used. Other information may be found at <http://blgf.gov.ph/manuals/>

Things to think about:



- > Why is property value information important?
- > Who **estimates** value? Who **determines** value?
- > What is the difference between bookkeeping value and market value, and why is this difference important?
- > What are the three approaches to value, and which ones are more relevant for different property types?
- > What kinds of information are necessary to prepare an appraisal?
- > In what circumstances is a professional independent appraisal necessary? Likewise, when is it appropriate for asset management staff to estimate value?
- > Independent appraisals are expensive and resources are limited. How are priorities established?
- > Suggest a good policy for selecting appraisers.

Activity 5: Operating Statements for Properties or Portfolios

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Systematically use operating statements for all properties (and premises)*
- *In the operating statements, all relevant revenues and expenses for each property and, in particular, management costs should be included*
- *A property management software should be developed and used that can assist city governments in managing their database.*

- *For portfolios of homogeneous properties (such as rental plots on public land), a portfolio-level income statement should be produced*
- *Prepare an annual budget or financial plan for each property, and then conduct a regular comparison and analysis of the actual and planned performance of the asset*

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

A problem in many local governments in Philippines is that financial performance data are seldom collected on a property-by-property basis. Rather, data are collected and presented at aggregated level, which is suitable for general accounting purposes, but not for effective real property asset management. Therefore, it is essential for the local government to introduce and continuously use formats for operating statements.

For real property asset management purposes, typical operating statements will consist of a summary of income and expenses. It is important to be flexible in formatting the statement, adding or deleting classes of income and expenses as appropriate. It is also useful to establish the report so that the actual results can be compared item-by-item with the budget and with the results from the previous year.

The typical report contains at least two columns of data: (a) current month results and (b) cumulative year-to-date results. Below is an example of such a report. In this simple form, it does not include the comparisons noted immediately above, but such comparisons only require adding the columns with such data.

**International Experience
Monitoring Financial
Performance In The City Of
Varaždin, Croatia**



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

Sample operating statement

Revenues	
Gross Potential Income (1)	1,000
Less Vacancy Loss (2)	50
Effective Gross Income	950
Operating Expenses (3)	
Repairs	100
Electricity	50
Water	20
Garbage Collection	20
Insurance	30
Taxes	50
Communal Fee	30
Property Management Fee	50
Miscellaneous (4)	10
Total Operating Expenses	420
Net Operating Income	530
Financing Costs	
Mortgage Interest	90
Overhead Costs	
Appraisal	10
Other (5)	5
Total Overhead	15
Net Income	425
Less Mortgage Principal Payments (6)	100
Cash Flow (7)	325

Notes

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

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

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

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

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

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

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

For the purpose of simplicity, depreciation is not considered as an expense in the sample statement shown above. In theory, it is an accounting for the long-term decline in value of a physical asset that will not last forever. Land is not depreciated, but buildings and equipment are depreciated, spreading the initial cost over a useful life. The cash is invested at the time the asset is acquired or the improvement is made. Thereafter, there is no cash cost (except for repairs). It is not appropriate to charge the cost of a new roof, for instance, in the year it is

installed because it will last for many years. Depreciation spreads the accounting for that cost over its useful life. But there is no cash expense each year, so if depreciation is deducted in arriving at Net Income, it must be added back to the Net Income to arrive at Cash Flow. Again, the example above does not show this detail. Whether and how to include it depends on the accounting standards for the public (governmental) sector accepted in the country. But the theory remains important for financial analysis purposes.

For properties that are not income generating, cash flow will always be negative but it still important to know it for comparisons with other properties, especially of the same type. For example, the costs of operating a rental office building may be similar to the costs of operating City Hall. By comparing detailed operating costs, it may be possible to identify costs that can be reduced.

For local governments, net operating income represents the relevant measure of performance for the property. It is expected that income and expense items will have an attached detailed breakdown of transactions.

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

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

Exercise: Use of Operating Statement Data



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

Building Number	Building Size M ²	Air Conditioning Cost in Pesos
1	450	5250
2	175	2150
3	380	4510
4	410	4980
5	525	6180
6	325	7480
7	220	2680
8	350	4240

What generalization can be drawn from this information?

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

(Suggestion: Begin by calculating the air conditioning cost per M²)

Things to think about:



- > Why is it important to maintain operating statements? How are they useful?
- > What can happen to make operating statements misleading or inaccurate?
- > Why is it important to maintain operating statements on non-income producing properties like City Hall and pre-schools?
- > How are operating statements useful in the process of preparing an appraisal?
- > Why is it important for one office to have full responsibility for the accounting for a property?

Activity 6: Intensive Financial Analysis of Portfolios, Properties, and Projects

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Train asset management staff at the city government to use discounted cash flow analysis*
- *Before property-by-property financial information becomes available, conduct an analysis of annual results regarding revenue, expenses, and net income (losses) based on aggregated (portfolio-level) data.*
- *To the maximum extent possible, consider portfolios of homogeneous properties (separate subsidized and not subsidized properties)*
- *Include in the analyzed data **all** relevant revenues and expenses for each portfolio (in particular, management costs).*

As discussed under Activity 3, city governments' property portfolios are very diverse in their content, size and character. They contain land, residential properties, office buildings and premises for governmental and semi-governmental use, non-residential (business) rentals, sport and cultural facilities, pre-schools, public markets, lighting infrastructure, industrial and warehouse/distribution real estate, and various enterprises.

In addition, local governments undertake projects, most of which include development of some kind of real property. In some cases, up to 70% of the city government budgets were for expenditures related to development and maintenance of real property. It is self-explanatory that such diversity of portfolios and projects has to be closely monitored and controlled, in order to achieve appropriate benefits and avoid financial losses and deterioration of properties. The primary means of achieving desired management objectives is to conduct **a feasibility study**, which includes the analysis of expected financial consequences for the local government, before engaging in any business, investment, or construction project.

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

By introducing individual **property level accounting** and relevant financial reporting on property (on the issue of reporting, please see Activity 9 and Annex 2), the local government will consolidate essential information on income and expenses for each property. (Currently this information is dispersed within the local budget reports and cannot be extracted from there

efficiently and reliably.) The city then receives the benefit of knowing the net income (cash flow) from the property. Properties that produce no income but incur expenses will have statements that show the details of the “loss” that is incurred or subsidized by the local government.

For example, the operation of the building used as City Hall results in a negative cash flow as any incidental revenues are not sufficient to pay the operating expenses of the building. Ultimately, the city incurs the cost of operating the building. This would appear on the property financial report (please see Activity 9 and Annex 2) as a single cost (Negative Cash Flow from Operating City Hall). The details of operating the building would appear in the Operating Statement for the property. This allows for a detailed report and analysis of all the costs of operating City Hall in one place, rather than including the various transactions in a general budget where they cannot be identified easily as applying to that building.

It is important to understand that revenues and expenses are related. Within the current practice, general budget reporting is not oriented toward property. It shows expenses in one part of the city budget and revenues in another part, which may be misleading. For example, the same property could be leased in two different ways. It could be leased under a “net lease” in which the tenant pays a lower rent and also pays all operating expenses including repairs. Or it could be leased under a “gross lease” with the tenant paying a higher rent but no expenses. The expenses would be paid by the city.

The end (net) result is the same for both parties in each case. In the first case, the city receives a lower rent but has no expense, and the tenant pays a lower rent and all the expenses. In the second case, the city receives a higher rent but also pays expenses, while the tenant pays a higher rent but incurs no expenses. The city could “reduce expenses” by using the net lease format, but the rents would also be lower, or it could “increase rents” with a gross lease but incur increased expenses as well.

TOOLS FOR THE ANALYSIS OF INCOME-GENERATING (SURPLUS) PROPERTY

Income-generating (surplus) property should be treated as investment property and, as such, analyzed against other feasible investments. The underlying logic is very simple and straightforward: The city does not need this property for its functions, and if it retains some specific property, this property should produce returns on investment, which are competitive -

after considering risk factors - against other available investment types (bank deposits, State securities, etc.). If the property is not generating sufficient returns, its performance should be scrutinized in order to see how the property performance could be improved. If improvement do not result in higher returns, the owner should consider selling the property and re-investing proceeds in another type of investment.

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

Tool 1

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

$$R = I / V, \quad (1)$$

Where **R = capitalization rate, I = income, and V = value**

The concept is that each of these three characteristics can be calculated if the other two are known. In particular, the capitalization rate (a simple rate of return) R can be calculated if annual income and property value are known (estimated). R (capitalization rate) can be used as a rough estimate of investment performance for one year. A key for the correct use of this rough estimate is to understand that I (income) should be net operating income. A version of this triangle formula was used in Activity 4 in the Income Capitalization approach in preparing an appraisal.

Net operating income or net cash flow (see Activity 5) is an absolutely necessary basic characteristic for any income generating property, because it puts together income and expenses and shows whether the property really generates net income or in fact it generates net loss. As discussed under Activity 5, net operating income is usually derived from an operating statement, which takes into considerations all revenues and expenses.

Exercise: Tool 1 for performance analysis



Please refer to the sample Operating Statement shown in Activity 5. In that statement, the Net Operating Income is shown as 530. For purposes of this example, let us assume the fair market value of the property is 15,000. (The numbers are for illustration only. They could represent thousands = or any other multiple - of Pesos, for example.)

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

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

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

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

INCREASE INCOME through:

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

DECREASE EXPENSES through:

- Saving on maintenance and repair without compromising property value
- Reducing utility expenses
- Minimizing management expenses
- Revising norms for contributions in reserve/replacement funds.

It must be noted that R is dependent on V as well as I. If the estimate of value is too high, then R will appear too low. It will seem that the cash flow is too low relative to value, but could be perfectly acceptable if a lower, more accurate, value was to be used. Likewise, if the value is shown too low, R will be more attractive than is justified. Therefore, it is important to have objective value data.

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

Tool 2

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

Operating expense ratio = Total Operating Expense / Effective Gross Income

Or complementary to this

Net income ratio = Net Operating Income / Effective Gross Income

Comparisons of line items of income and expense on a “per square meter” basis is also very useful (see the box II.6.1 above). These ratios may be within different ranges for different types of properties (for example, for residential and business rentals).

DISCOUNTED CASH FLOW ANALYSIS

A more Strategic technique for analyzing income real property or investment projects is Discounted Cash Flow Analysis. This technique provides an estimate of the market value of a property or project based on revenues and expenses which are incurred over time. It is especially useful when there is a need to make a financially sound choice among two or more alternative uses of the same property or among alternative investment projects.

Discounted Cash Flow is based on the premise that money is worth more today than if one must wait until a later date to receive it. Simply stated, would you rather be given one million pesos today or one year from today? Clearly, it is better to receive it today and invest it for a return during the year. So future revenue is worth less than present revenue. The purchase of an asset today (or the decision to not sell it and receive its value today) entitles its owner to receive the cash flow it produces and eventually the proceeds of its sale. The discounted cash flow is today’s value of the future flow of revenues from the operation and the eventual sale of the asset. The amount of the discount, a percentage, should reflect returns in the investment market. A higher discount rate means that future revenues are worth less today, while a lower discount rate results in a higher value today. Likewise, revenues further in the future are worth less today than revenues received sooner.

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

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

Example 1

The city owns an unimproved and unused parcel of land and wishes to sell it. A company offers to purchase it and presents two alternative proposals. It will pay 1 million Pesos to the city immediately, or it will pay future operating costs for keeping the parcel unused (so that the city has no expenses) and will purchase the property in ten years for 2 million Pesos. It is the opinion of city officials that its cost of capital is 10%. Which proposal should the city accept?

Answer:

2 million in 10 years, discounted by 10%, is 771,087 today, or less than the 1 million offered for cash today. Given the assumptions, the cash offer of 1 million Pesos is better.

Example 1a

Assume the same example as above with one change. The city is using the plot as a parking lot, which generates the net income of 50,000 Pesos per year. The purchaser offers to pay 50,000 Pesos per year to the city for ten years and will then purchase the property for 2 million Pesos. Which proposal should the city accept?

Answer:

The 771,087 net present value of the 2 million discounted 10 years at 10% remains, but we need to add the net present value of the 50,000/year. The net present value of that flow of cash is 307,228. The total of the net present value of the later sale price and the cash flow in the intervening years is therefore 1,078,315, more than the 1 million cash offered today.

Example 2

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

Net Income (Pesos)		
Year	Property 1	Property 2
1	100,000	500,000
2	100,000	500,000
3	100,000	500,000
4	100,000	500,000
5	100,000	500,000
6	500,000	100,000
7	500,000	100,000
8	500,000	100,000
9	500,000	100,000
10	500,000	100,000

Answer:

Property 1 has higher cash flows later in the time period of ten years, while Property 2 has higher cash flows earlier, although each has total cash flow of 3 million Pesos. It is always better to get money earlier than later. The difference in value depends on the discount rate used, but in each case Property 1 will be worth less because of the timing of the receipt of the larger sums.

Example 3

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

- One company proposes to lease the property for 25 years for annual rent of 1,020,000 pesos per year, provided that certain improvements are made to the property so that it can be used efficiently and comfortably. The company offers to lend the money to improve the property. It estimates the cost of improvements at 8 million pesos, which it will lend to the city at an interest rate of 12% to be repaid over 25 years.
- A second company has offered to purchase the property in its present dilapidated condition for 1,000,000 pesos.

Which is the better offer to the city? Why?

Answer:

In the deal with the first company, the mortgage payment costs will be 1,020,000 Pesos/year, equal to the rent. Hence, the city will receive no cash flow for 25 years. At the end of 25 years, the value of the improvements will be reduced by 25 years of usage and deterioration. Even if the property retains significant value from the improvements, it will be 25 years before a new lease or sale of the property will produce value, and the net present value of anything 25 years from now is limited. With the information provided, one must make assumptions for further analysis.

Let us now consider very optimistic assumptions about the first offer: that the property in 25 years will be worth 9,000,000 Pesos. This is based on the assumption that the property “as-is” today is 1 million Pesos and that this value remains unchanged over 25 years, and that the improvements of 8 million will completely hold their value without any deterioration or depreciation over 25 years. Furthermore, let’s assume that the city requires a return of 15%. No inflation is assumed. Under such assumptions, should the city sell immediately for 1 million Pesos or lease for 25 years as described?

The net present value of 9 million Pesos 25 years from now discounted at 15% is 273,399 Pesos, less than the 1 million offered in its “as is” condition. The 1 million cash offer is better.

Example 4

A property is appraised at 20,000 Pesos and produces annual net income of 6,000 Pesos. Is this a good investment?

Answer:

This is 30%! That is very good. But are all the costs of holding the investment accounted for? Operating an asset management department is costly, and each asset must be monitored. If, for example, the cost per property for asset management (oversight) is 5,000 Pesos, this becomes a poor investment. We must look deeper than simply the property return.

Example 5

What are the elements of the interest rate?

Answer:

Riskless rate of return (safest possible investment)

Inflation

Tax cost

Credit risk

Operational risk

Other risks (currency, etc.)

Perhaps others!

In addition to net present value and discounted cash flow, there are other tools (such as amortization and internal rate of return) useful for financial analysis of real estate investments and projects. Manual calculation is possible but impractical, and inexpensive financial calculators are widely available. Most have excellent operating manuals that not only teach the steps to make the calculations but also thoroughly explain the use of the calculations. The reader is strongly encouraged to become proficient with these tools.

International Experience
Financial Analysis of Property in
the City of Varaždin



Varaždin's asset management staff has learned financial analysis tools and is using them for business rental properties, housing, and sports facilities. The financial analysis training was based on actual examples involving reconstruction of former military barracks, proposed acquisition of state-owned business premises, and other property situations.

Activity 7: De-regulation of Business Rentals and Improvements of Rental Practices

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Revisit and revise the City Government Ordinance regulating the use of government's premises for business rentals*

- *Improve bidding procedures and the standard lease agreement in order to ensure better marketability and profitability of local government's business rentals*
- *Revise management of rental properties, both business and residential, to systematically improve overall efficiency (in particular, to be able to monitor financial performance of all rental properties and portfolios, increase collection rate, decrease management costs, etc.)*
- *For cities with housing loan portfolios, put servicing on an open competition, and encourage banks to participate.*

DE-REGULATION

The current policy and practice of leasing business premises by city governments in the Philippines needs to be revisited at the same time consider the market economy.

Particularly in other countries where there is over-regulation of leasing business premises, mostly negative consequences were observed in the local economy. Over-regulation takes place along several lines.

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

Any additional limitation imposed on property use also lowers potential income; hence, lowers property value, which the owner may obtain through lease or sale of the property. Moreover, those limitations tend to increase vacancy and lead to deterioration in the condition and appearance of the property and the surrounding area.

IMPROVING RENTAL PRACTICES

Critical areas of improvement of asset management performance by local governments in Philippines include improving leasing procedures and contracts, increasing the rent collection rate and reducing operating and management costs. Capital expenditures, to improve energy efficiency, for instance, may reduce operating expenses or increase the rent the tenants are willing to pay, or both.

IMPROVING LEASING PROCEDURES AND CONTRACTS

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

For increasing the efficiency of local governments' rental practice, it also would be useful to make some changes in standard business premises lease contracts and leasing procedures.

1. Currently, many of the tenants of the local governments' premises have the right of unlimited number of extensions especially for good payers/renters. For non-residential properties, a more common approach is that if a tenant wants to extend the lease, he

International Experience Some key economic principles underlying real estate



1. An owner seeking a buyer or tenant should make every effort to reduce uncertainty (risk) and restrictions that would limit the opportunity and increase the risk premium to the buyer or tenant. With reduced uncertainty and limitations, the buyer can pay a higher price and the tenant can pay a higher rent, fully maximizing the economic value of the asset.
2. Rights of lenders and owners must be protected. If rental housing is important, especially for young families without the resources to own a home, then investors must be induced to provide capital for that housing. A key inducement is protection of their rights to collect rent or evict the tenant and lease to another. If mortgage financing is important to help families acquire a home, then lenders must be induced to make those loans by assuring them they can foreclose on their collateral to protect their investment. If something is important to society, then the rights of those who would provide it must be protected.

or she should notify the real property manager in writing at least 3 months before the lease expiration date. The real property manager and tenant then negotiate a new lease before the expiration date.

2. The system of adjusting rent at the moment of contract extension could be introduced. The tenant would not be able to occupy the space indefinitely without paying increased rent when market prices rise substantially. A common arrangement in commercial leases is that at the moment of lease extension for a new term, rent is revised and brought to the market level (usually, to 95% of a fair market rent in order to create an incentive for the tenant to continue to stay at the premises and to recognize the importance to the owner of uninterrupted cash flow through continued occupancy). Another approach is to adjust the rent on a periodic basis reflected in a contract/lease agreement. The number of renewal options (terms of months or years) should be limited.
3. Many current contracts do not require a real property manager to notify a tenant in advance if the rent will be adjusted (the tenant will learn about this from a payment slip). A standard practice requires notification to a tenant about an adjustment at least 30 days in advance. Also, the methods and possible frequency of rent adjustments are commonly described in a contract/lease agreement itself.
4. The local governments should give at least 20 to 30 days from publishing an advertisement of available premises until the deadline for applications. Shorter periods between publishing and the deadline are inadequate to allow sufficient consideration by prospective tenants.
5. There are three important rules that are considered standard in the real estate industry for conducting this kind of public tender or competition (known as “sealed bid competitions”):
 - The terms of the offering should be clearly stated. It should describe the premises, the term of the lease in years or months, the party responsible for operating expenses and capital expenses including preparing the space for occupancy, and other relevant factors.
 - All offers (bids) should be kept in sealed envelopes until the stated time of opening, and
 - The bids should be opened and read in the presence of all applicants who care to attend the bid opening and learn about price offers immediately (though formal notification to the winner can be sent later).

INCREASING COLLECTION RATE

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

International Experience Deregulating Business Rentals in the City of Varaždin



The City of Varaždin reports that, by more broadly defining the permissible uses of property and increasing the transparency of leasing competition, business rental revenues have been substantially increased. Further, improved rent collection and mortgage enforcement practices have produced greater revenues and collections and have reduced delinquencies.

REDUCING OPERATING COSTS

Keeping total operating expenses associated with all local government assets under control and scrutiny should be among the key tasks of local government asset managers.

In many cases, total costs for operating property portfolios are not known, partly because the function itself is split among several management entities. Usually, private real estate management firms provide partial management service for asset portfolios. Better services and lower costs will be obtained if management firms are required to compete for management contracts and if they are required to obtain property services at the lowest possible price. It is not likely that optimum results will be obtained if the property management company also provides maintenance and other services.

Things to think about:



- > Why is a transparent bidding system important?
- > How do restrictions on the use of property limit the potential rent?
- > Why is it important to protect the rights of lenders and owners?
- > What are the purposes of regulatory limitations on property use?

Activity 8: Quantifying and Monitoring of Direct and Indirect Property - Related Subsidies Obtained by Tenants and Users of Local Government Real Properties

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Monitor rental prices in the private sector in order to estimate indirect rental subsidies obtained by tenants of local government's premises*
- *Sort out which properties are associated with various types of local government support (such as below-market rent, subsidies to tenants for operating expenses or direct payment of operating expenses by the local government, etc.)*
- *Monitor and evaluate amount of these subsidies for each property and each property portfolio, beginning from properties occupied by NGOs, regular business rentals, sport facilities, and cultural facilities*

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

The income that the local government forgoes by renting property for below-market rent constitutes the indirect property-related subsidy that tenants of such premises obtain from the government.

The total amount of forgone income is difficult to estimate without special monitoring. Expert opinion is that, in some practical cases, average rental prices (and annual rental income) for local government property could be twice as high as currently the case.

**International Experience
Indirect Subsidies in Croatia**



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

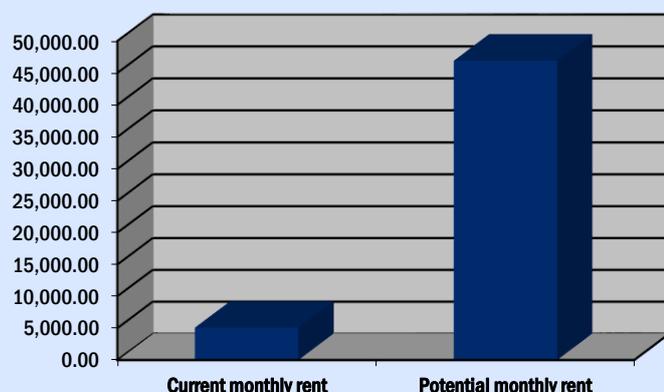
An impressive example of indirect rental subsidies is provided by the case of not-for-profit organizations. There are many premises allocated to them, with substantial total floor area and located in the most prestigious and expensive zones in the historic or business centers. In some cases, not-for-profit organizations pay symbolic rent, which may be dozens of times below market, and the indirect rental subsidies to them can be 360 Kuna per square meter annually, and more.

A decision on whether indirect rental subsidies (and of what size) should be provided to tenants occupying a local government's non-residential premises is completely political. However, decision makers should be well informed about the costs of the subsidies, and supplying them with this information should be the responsibility of the local government's asset managers.

**International Experience
Indirect Subsidies in Varaždin**



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



In particular, for each premise, asset managers should know at least the estimated market rent; then the size of the subsidy can be estimated for each premise as:

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

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

Estimating Indirect Subsidies to Social Rental Tenants					
Tenants	Address	Area (m2)	Actual Rent	Market rent	Difference = Indirect subsidy
1					
2					
3					
4					
TOTAL					

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

In general, existing policy and practice could be improved in three ways:

- Improved efficiency of the use of space by local government, retailers and other businesses, and non-profit groups could significantly reduce costs and/or improve rental revenues to the local government;
- The local government's budget – and, as a result, the local government's populations – could earn substantial annual revenues, by removing unnecessary restrictions on property use and the accompanying substantial subsidies built into rental prices;

International Experience
Managing Premises for NGOs in Varaždin



Varaždin has made plans to relocate NGOs from prime space to the reconstructed military compound. Their use of space is being further rationalized so that, where possible, NGOs can share space (by using the same premises on different days). Also, leasing practices are being revised to provide more direct subsidies and less indirect subsidies. These measures together are expected to increase revenues by 500,000 Kn and increase the number of NGO users of City premises by about 20.

Subsidies to sports clubs are being analyzed and contractual agreements with them are being revised on a large scale.

- Subsidies to tenants could be significantly rationalized.

With the upcoming substantial reduction of the local government rental portfolios, lifting unnecessary regulations and leasing the remaining rental stock at market prices will help the local government compensate for losses of rental income caused by restitution.

Things to think about:



- > What practices of local governments reduce potential income from rental properties?
- > How can those practices be changed to reduce indirect subsidies and increase revenues?
- > How should a city decide which entities are deserving of indirect subsidies?
- > Why are good management practices important in managing NGOs?
- > What private businesses (if any) are deserving of indirect support in the form of reduced rent?
- > How does use restriction help the favored user and hurt other potential users?

Activity 9: Reporting on Property

RECOMMENDATION FOR IMPLEMENTATION:

- *Introduce and test a format for an annual report on city local government property assets*

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

According to the ADB Report, “almost half of the LGUs surveyed do not analyze financial performance of their public enterprises; More than 2/3 of all LGUs surveyed do not analyze effectiveness of operating costs; about 2/3 of all LGUs surveyed do not analyze effectiveness of maintenance costs.”

City government needs develop a standard form of reporting, and both those preparing the reports and those receiving them should either agree that

the format and content are acceptable or reach agreement on appropriate changes. The report should provide enough information to meet the needs of the public, but the Asset Manager should not be burdened with presenting unnecessarily detailed information.

To the extent that goods and services including labor are provided to the properties held by the city in exchange for other goods or services such as free or reduced rent, it is necessary to place a value on those goods and services exchanged to fully evaluate the cost of owning and operating the properties.

The report can be divided into a narrative, summary section, and detailed section. The narrative section provides an overview of the performance of the assets under management and the economic environment in which they are being managed. The summary section provides data on the portfolios of similar properties such as government-occupied property (i.e., City Hall), types of surplus properties, social housing, etc. The detailed section includes a report on each property including physical and financial data following COA standard reporting.

If a property is leased to private tenants at market rental rates, it is not important to know the details of their operations beyond that information needed to assure their compliance with the terms of the lease.

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

**International Experience
Reporting on Property in
Varaždin**



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

**International Experience
Asset Management Report**



There is one principal rule regarding reporting. It is this:

Reporting should provide all, but only, the information necessary for those receiving the report.

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

Appendix 2 contains a sample format for a property report. In the future, such a report may become a part of the overall financial reporting at the city government, and should be treated as a component of a consolidated reporting system. This document should be easily available to citizens.

Things to think about:



- > Why is reporting necessary?
- > Who should receive, or have access to, the report.
- > What information is needed?
- > What practical limitations should be placed on the amount of information that is reported? What is the needed level of detail?
- > What kinds of information change over time? What information remains unchanged?

Activity 10: Management Consolidation

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Centralize the management of all real properties in one department, office or unit.*
- *Use existing services (such as accounting) provided by other departments of the local governments as extensively as possible so that services do not have to be duplicated*
- *Identify all components of asset and property management where competitive outsourcing to the private sector would result in higher efficiency, and begin the systematic use of outside contractors chosen competitively*
- *Introduce non-financial incentives for the asset management staff through an ordinance and in consideration with existing Civil Service Commission (CSC) and Commission on Audit policies.*

Asset management, with few exceptions, seems much too fragmented and split among several managing entities (City Assessor's Office, General Services Office, City Accounting Office and more), while none of them has a full picture of the situation. Organizationally, asset management in local governments in Philippines may be improved in at least two ways.

The first is to strengthen the existing City General Services Office (GSO) as the central asset management department, office or unit that is responsible for development and implementation of the strategy, programs, and specific actions regarding local government property holdings. Among routine obligations of the GSO, the most pressing is to organize the consolidation and tracking of all information that is needed for prudent asset management, including financial information about properties and portfolios. The GSO, together with the members of the Expanded Local Finance Committee should develop plans for improving the financial performance of individual assets and portfolios and prepare regular reports on local government property holdings and their performance.

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

accountability of contractors and vendors for the results. Contracting of services should also consider existing Commission on Audit (COA) rules and regulations.

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

The asset manager will have the following minimum competencies:

- Adequate knowledge, skills and competencies on: strategy development, asset management planning, implementation and monitoring, risk management and performance management,
- Sufficient knowledge of financial modeling, The Asset Manager should be able to prepare feasibility studies and producing reports in relation to property acquisition, disposal and refurbishment.
- Good reporting Skills. The Asset Manager must be able to effectively report to the City Mayor and the City Council on the financial and operational performance of LGU assets.

A staff of three or four highly qualified asset managers with administrative or clerical support should be capable of handling a portfolio of approximately 225 properties. Responsibilities for each property would include retaining a property management firm, overseeing the work of that firm, and reviewing and approving annual budgets prepared for each property by the property management firm. Moreover, the asset manager would be responsible for monitoring maintenance, developing capital improvement plans, recommending the sale of surplus properties and executing approved sales, reviewing monthly income statements for each property, assuring that the property manager is effectively collecting all rents, and other related activities. A threshold level of authority should be established specifying the amount of pesos,

under which the department can make decisions regarding capital transactions and over which the decision, should be approved by the City Legislative Council or its designated committee.

Local government staff may retain property management responsibility for some properties such as local economic enterprises. However, many cities and other governments have found it beneficial to retain independent property management firms to manage these assets as well, primarily to assure good management at a low cost.

The private property management company should also be required to retain independent contractors for work such as repairs and landscaping rather than performing this work with its own staff. This practice, if properly executed, will contribute to lower costs and better service.

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

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

Asset Manager

- Complete oversight of the assets
- Maintenance of records of each asset
- Coordinate with the Bids and Awards Committee the selection of a property management firm
- Supervision of a property management firm (property manager)
- Together with the City Accounting Office, conduct review of the financial performance of each asset
- In coordination with the City Treasurer's Office, conduct monitoring of the monthly remittance of cash flow from the property manager
- Coordinate with the City Assessor's office the ordering and review of appraisals (and documenting the estimates by the asset manager of the value of smaller properties)
- Plan and executing capital improvements
- Work closely with the Expanded Local Finance Committee and the City Legislative Council on the approval of rental rates and participation in the negotiations of major leases

- Recommend the sale or retention of the asset
- Assure that each property is insured appropriately
- Facilitate annual formal review of each asset
- Take lead the evaluation of the performance of the property management firm
- Conduct periodic inspections (at least annually) to assure appropriate physical maintenance
- Other functions as necessary to assure the optimum performance of the asset and the preservation of its value

Property Manager (City Department/Office or Private Property Management Company)

- Act as agent in supervising the day to day operations of property, with full loyalty to the owner
- Find tenants to lease the premises
- Assist the Asset Manager in negotiating large leases
- Sign leases for smaller tenants according to an approved lease form and rental rate
- Collect rents
- Pay expenses from collected rents or from funds provided by the Asset Manager
- Remit the net cash flow to the owner (asset management department) each month
- Arrange for necessary services provided by independent contractors such as painters, carpenters, roofing contractors, and others, and assuring that their work is of good quality
- Prepare monthly and annual financial reports for each property
- Propose annual budgets for approval by the Asset Manager
- Conduct regular inspections to assure good maintenance
- Other functions as directed by the Asset Manager

Things to think about:



- > Why is consolidation of asset management within the Local Government important?
- > What are the key differences between asset managers and property managers?
- > Recall the difference between maintenance and management.

Activity 11: Strategic Asset Management Plan

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Develop a Strategic Plan for asset management, including priorities of tasks*
- *Obtain approval of the Strategic Plan by the City Legislative Council*
- *Ensure implementation of the Strategic Plan according to the developed schedule*

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

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

- What's the over-all strategic goal of the City Government in terms of real property asset management?
- How many properties local governments must own or support for providing their mandatory functions and supporting social programs
- How should social goals of property ownership be balanced with financial circumstances of the local governments? In particular, how big should direct and indirect property-related subsidies to various tenants be?
- How the City Government can fully utilize its assets and achieve increase in return of investment?
- What should be the policy regarding disposal of unneeded assets or surplus property owned by the local governments?
- In what situations should the local governments get involved in business enterprises? How much may they invest in businesses? What is their risk tolerance regarding business involvement? Should a government enterprise compete with private entities in the same business?
- How to meet customer satisfaction?

It is particularly important to reflect in the Strategic Plan that local government asset management includes a much wider range of issues than those that were until recently dealt with by various local government departments. Asset management is not only assurance of

operational maintenance and repair of city real property but also making economically and socially justified decisions on property reallocation, change of use, and disposal. It also should address complex questions of local government business activities and involvement in the ownership of various enterprises. A number of decisions will address the question of sorting out how various specific properties should be used (for obligatory functions, for voluntary subsidized social functions, and for income generating through “highest and best” use).

According to the World Bank paper and the Asian Development Study, an Asset Management Plan should have the following elements:

a. Strategic Goals

The strategic goals of the organization will provide the starting point for identifying the full scope of assets that will be needed to achieve these goals. If the strategic goal is to improve the safety and efficiency of transportation means in the local government; then the assets, such as subway, bus, new road network, bridges, etc., will be more easily identified.

b. Levels of Service and Performance Standards

Given the strategic goals and identification of assets that are needed to support those goals, the levels of service and performance standards can be derived. Using the example of the transportation system, the levels of service can be defined by accessibility to the system, the travel time reduction by providing the asset, and the performance standards might be the increase in number of people utilizing public transport and reduction of travel time by a certain time requirement.

c. Growth and Demand Projections

The population and geographic growth of the local government unit must be assessed and projected for the future years in which the asset will be utilized. For example, if the local government is experiencing population growth and this growth is occurring in certain areas of the local government, this growth and potential increasing demand for the services to be delivered by the asset must be factored into the asset management plan. Building a transportation, water, or sanitation the and areas of the local government might well mean that the asset once completed cannot serve the population as it exists at the time of being put into operation.

d. Asset Management Strategies

- i.* This section of the asset management plan should identify the main options and alternatives among specific assets that might achieve the goals and service levels needed. The asset management strategies might address the asset alternatives to improve the transportation system. For instance, the asset management strategies might identify the alternatives of improving the existing road and bridge system as opposed to new roads/bridges that might circumvent the most congested areas. Other alternatives, such as subways, buses, and the use of private transportation providers might also be considered. The identification of these alternatives can lead to selecting the possible assets and the strategies to acquire the needed assets Tactics.

As indicated in the World Bank report, this is the most important part of the asset management plan. Once the asset management strategy is identified, the tactical means of obtaining the asset based on the technical feasibility of obtaining or constructing the asset, and the operational performance over the life cycle of the asset must be addressed in this section. This section provides the basic blueprint for implementing the asset management plan for each of the alternatives and service delivery areas that address the strategic goals and the levels of service previously identified.

- ii.* Projections including Cash-Flow Forecasts

This section is an extension of the asset management tactics section as it more explicitly addresses the financial and economic analysis of the acquisition and operation of the asset over its expected useful life. The important features of this section are to address the cash flow requirements of the asset and how the operation and maintenance of the asset will not pose substantial burdens in the future. The use of cost/benefit analysis, net present value, and other rate of return calculations form the basis for the analysis that is included in this section.

- iii.* Monitoring, Control and Review Mechanisms

It is important to include in the asset management plan the mechanisms for reviewing the basic elements of the asset management plan to determine if the strategies, tactics, and financial analyses are realistic, based on the best available information and estimations. In addition, if there are potential discrepancies or inconsistencies in the asset management plan these can be

readily identified and assessed. This monitoring and review mechanisms can then lead to changing the strategies and tactics before it becomes too late and the asset represents a sunk cost that cannot be recovered.

iv. An Asset Management Improvement Plan

This section addresses the management processes and the procedures of the asset management plan to ensure that the plan will be updated and improved over the course of the assets operations. This asset management improvement plan would encompass the processes of the management activities, the data and knowledge of the performance of the asset over its period of operation, the development of information systems that will obtain and maintain this information, and any changes that can be anticipated or expected in the coming period that might impact the asset operation.

Please see Annex 6 for the template or guide for *Building Effective Asset Management*.

After the Strategic Plan is developed and approved, the local government should review it periodically to measure progress, assure its continued relevance, and update as necessary.

The development and approval of the Strategic Plan, however, is not a reason to delay beginning the implementation of good asset management practices. Data can be gathered and organized, and sound asset management decisions can be made within the context of existing laws and regulations.

The City General Services Office, together with the members of the Expanded Local Finance Committee will lead the formulation of the Asset Management Plan. Other stakeholders, such as representatives from the Business Sector or Chamber of Commerce may be involved. The City Development Council and the City Legislative Council should adopt the Plan.



Things to think about:

- > Why is a Strategic Plan important?
- > What issues should a Strategic Plan address?
- > Why should a Strategic Plan be reviewed periodically?
- > What activities can proceed before a Strategic Plan is prepared?
- > What decisions should await the preparation of a Strategic Plan?

III. NEXT STEPS

The Real Property Asset Management Manual for Local Governments in the Philippines addresses the range of issues that constitute the first layer of asset management reform in CDI cities. However, there are some other very important tasks that also fall in the asset management domain, which we were not able to discuss in this manual. It seems useful at least to name the most important among them and outline recommendations for improvements.

III.1. Local Government Involvement in Enterprises

Recommendations for implementation:

- *Increase the level of attention to the relationship between the local government and utility enterprises. The objective of this scrutiny and improvement is to ensure that the local government provides sufficient oversight to the utility operations, including: the quality of services to consumers; technical, financial, and management efficiency; accountability of the utility's management; and investment in maintenance, repair, and growth.*
- *Reduce involvement in all other non-utility enterprises in order to separate the local government from business activities and associated risks. This separation may proceed along two avenues:*
 - a. *Sell business interests completely, or*
 - b. *In cases where the local government must retain ownership of assets given to such enterprises, reorganize the arrangement by separating the ownership of the assets (public) and their management (private) on a contractual basis, in particular through the new generation of public-private partnerships (see below).*

According to the discussion paper on - *Developing the Public Economic Enterprises in the Philippines*, “local governments are involved in a wide range of public economic enterprises in Philippines. The paper stated that “Public Economic enterprises are entities owned wholly or in part by government that offer a product or service from which revenue may be

generated including public markets, bus terminals, slaughterhouses and cemeteries. They also involve complex enterprises such as electrical power and water distribution facilities, ports and harbors, integrated transportation terminals, major tourism facilities, medical services and clinics, and information technology providers”.

The paper also stated that “Many of these public enterprises are often poorly managed rarely profitable and frequently run at a loss, requiring subsidies from already cash-strapped LGUs. The services provided by the public enterprises are often of substandard quality and in some cases are located in unsafe or unsanitary conditions. For example, public slaughterhouses that do not meet National Meat Inspection Commission (NMIC) standards; public wet markets with inadequate facilities for vegetable storage, animal holdings and waste disposal; and public terminals with poor/absent toilet facilities, are common”.

The paper further noted that “Having some control over local utilities seems to be an imperative for local governments in Philippines, practically and politically. However, ownership might be not the only way to meet this need. In any event, the issues associated with local utilities constitute a special area within the domain of local government asset management and should be addressed accordingly”.

While we recognize that in the Philippines context, local governments will therefore remain involved in local utilities, the involvement of local governments in other types of enterprises in most cases is not sufficiently justified. Government ownership of businesses results from a variety of circumstances – residual inertia from an inherited situation, a desire to protect or create jobs, pressure from interest groups close to the city government, pursuit of private interests by members of the city government, and so on. Whatever the reasons are, there are serious arguments against this type of involvement, based on both international and Philippines experience, including the following.

- Involvement in business is not a function of government
- Governments are not efficient business entities or owners
- Too many risks are associated with owning or running business

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

The paper has also introduced the Alternative Service Delivery (ASD) Framework. According to that framework and study, “the ASD is a decision framework and critical thinking process in which the local governments determine the criteria and risks that need to be satisfied to arrive at the best-balanced choice. They are challenged to assess the consequences of alternatives selection, to account for policy imperatives and political variables, and to anticipate managerial problems arising from the delivery option selected. It consists of test questions upon which the decision tree will be based to help narrow the range of alternatives concerning Public Economic Enterprises (PEEs)”.

The alternative service delivery options are arrayed to illustrate how each potential choice represents a placement on continuum involving the public and private sectors and control exercised by government or independent entities.

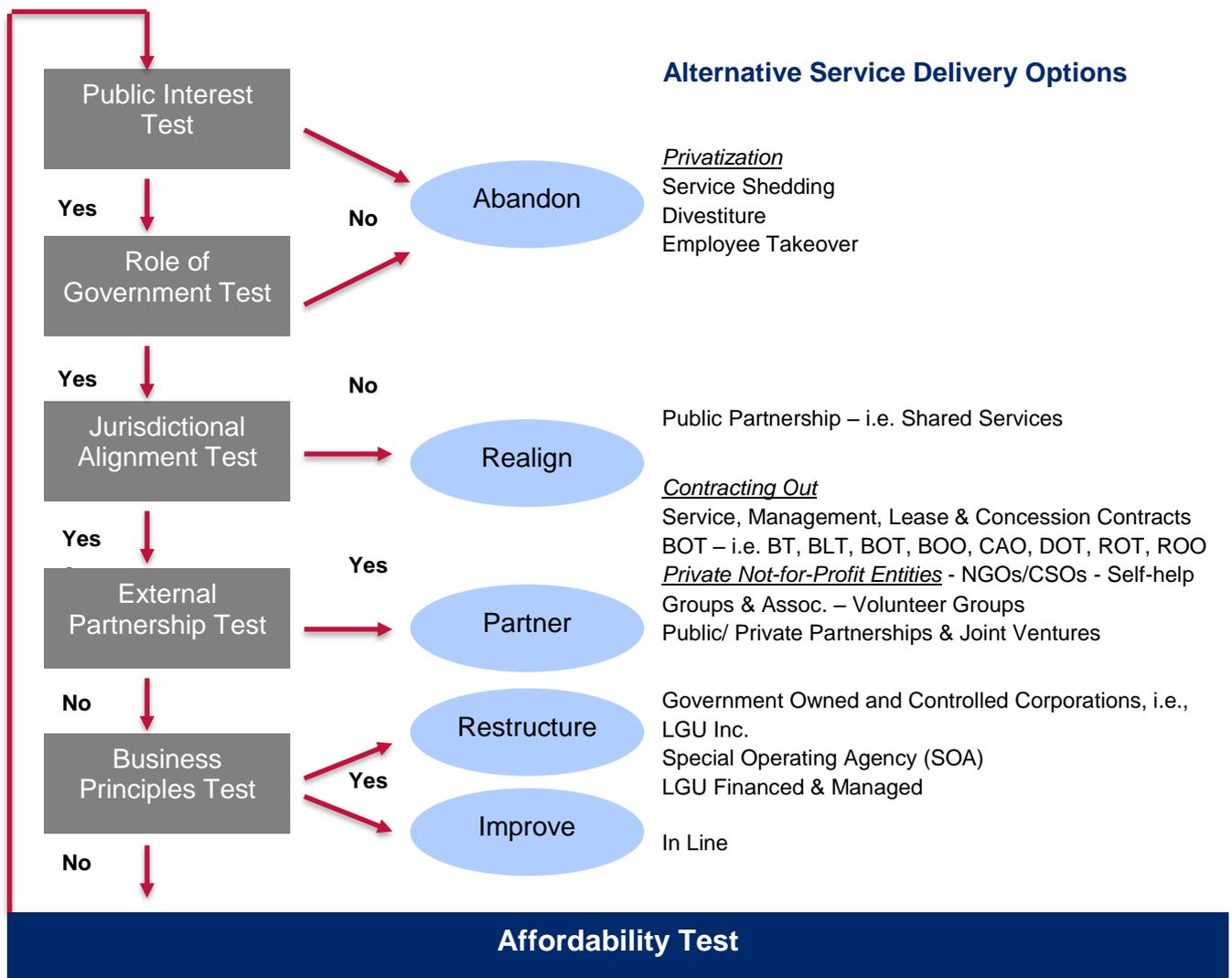
Before deciding on any option, services offered in-line or through an existing PEE need to be sorted into government’s core and non-core functions and then screened against the delivery options. Non-core services may be abolished where not critical to the public interest, privatized where contestable, contracted out where measurable, or transferred elsewhere in the public sector. The result is a slimmer public service focused on core activities.

The following is the framework test questions:

FRAMEWORK TEST QUESTIONS		
Strategic Focus	Questions	Possible Sources of Information
Public Interest Test	Does the program or service continue to serve a public interest?	<ul style="list-style-type: none"> • Feedback from customers/clients
Role of Government Test	Is there a legitimate and necessary role for government in this program or service?	<ul style="list-style-type: none"> • Local Government Code
Jurisdictional Alignment Test	Is the lead responsibility for this program or service assigned to the right government jurisdiction?	<ul style="list-style-type: none"> • Local Government Code
External Partnership Test	Could, or should, this program or service be provided in whole or in part by the private or voluntary sector?	<ul style="list-style-type: none"> • Listing of CSOs from the Local Development Council • Discussions with the local Chamber of Commerce and Industry, etc.
Business Principles Test	If the program or service continues within the existing government context, could its efficiency and effectiveness be improved?	<ul style="list-style-type: none"> • Feedback from customers/clients • Results from previous enterprise assessments/audits
Affordability Test	Is the program or service affordable within fiscal realities?	<ul style="list-style-type: none"> • Results from feasibility study

Source: Sequus, “The Local Government Support Program, Public Economic Enterprise Model- Developing the Public Economic Enterprises in the Philippines. The LGSP Way”

Alternative Service Delivery Framework



Source: Philippines-Canada Local Government Support Program, “Alternative Service Delivery in the Philippines. A Decision Framework”, June 2003

II.2. Property-Related Public-Private Partnerships (PPPs)

RECOMMENDATIONS FOR IMPLEMENTATION:

- *Identify properties that would benefit from PPPs*
- *Design, plan, and launch one or several pilot PPPs, each in a form that is relevant to a specific property*

A worldwide trend in addressing governmental needs to invest in, build, and operate real property and infrastructure for public use is related to a new generation of public-private partnerships (PPPs). For this generation, “PPP” is an umbrella term used for many forms of private sector involvement in the provision of traditionally public sector services. PPPs can take the form of management contracts, leases, concessions, BOTs (built/operate/transfer), outright privatization, or more complex deals, for example those that include sale-lease back arrangements.

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

- The possibility of private finance replacing public finance on many projects
- Shifting risks from the public sector to the private sector
- Speedy, efficient, cost-effective delivery of projects
- Efficiencies from integrating design, construction, operation, and maintenance (including life-cycle costing)
- Transfer of private sector skills
- Greater accountability
- The possibility of clearing public balance sheets

THE CONCEPT OF BOT IN THE PHILIPPINES

The private sector finances the investment or any of its variants (per RA6970 as amended), operates it for a certain period of time after which the asset is transferred to the LGU. The private party is

allowed to collect user fees to recover its costs and earn a reasonable rate of return on its investment. The LGU and the BOT proponent negotiate on the risk sharing.

Some of the variations:

- **Build-and-Transfer (BT)** – The private sector finances and constructs an infrastructure or development facility. After its completion, the private sector turns it over to the LGU, which pays the contractor the total investment on the project
- **Build-Lease-and-Transfer (BLT)** – The private sector finances and builds the facility. When completed, the facility is leased by the local government for a fixed period after which ownership is transferred to the LGU
- **Build-Operate-and Transfer (BOT)** – The private sector finances, builds and operates the facility over a fixed term. During the period, the private sector charges facility user's appropriate tools, fees, rentals and charges not exceeding those proposed in its bid or as negotiated and incorporated in the contract to enable the private firm to recoup its investment, operating and maintenance expenses. The private sector transfers the facility to the LGU at the end of the fixed term, which shall not exceed 50 years
- **Build-Own-Operate (BOO)** – The project proponent finances, contracts, owns, operates and maintains the facility, and collects tolls, fees, rentals or other charges from users
- **Build-Transfer-and-Operate (BTO)** – The contractor builds the facility on a turn-key basis, assuming cost overruns, delays and specified performance risks. Once the facility is commissioned satisfactorily, the title is transferred to the LGU; however, the private entity operates the facility on behalf of the implementing agency under an agreement

Drawn upon the discussion paper “Local Governments and Public Economic Enterprises in the Philippines” by the Philippines-Canada Local Government Support Program

BOT is a form of public-private partnership where real estate or infrastructure for public use (such as governmental buildings, public hospitals, or roads) is delivered by the private sector. The difference from a traditional procurement is that the private sector is involved on a wide scale – to finance, build, and operate the asset. The cost of the project will eventually be met by the public sector (except where there are external sources of revenue, for example from toll roads). Nevertheless, BOT arrangements have a number of advantages for the public sector:

- Built-in powerful incentives to deliver capital projects on time and to budget

- The financial rates and the project costs for the public sector are fixed on day one. All risks associated with project overrun are transferred to the private sector.
- Typically the life-cycle cost of the asset is reduced by 10 – 20% because it is factored into the initial design
- Quality of maintenance is better because necessary expenses are built into the initial contract and cannot be raided later by politicians if their expenditure priorities change. This protects assets from neglect.

The structure of local government responsibilities in Philippines indicates that use of these types of PPPs can be a beneficial solution in a number of situations. Some of them, such as contracts with private companies to manage specific existing properties or portfolios, were discussed in previous chapters - though without using the term “PPP”. However, some cities may be well positioned for testing more advanced PPPs. In particular, this approach can be introduced for reconstruction of properties that local governments are legally obligated to own, though their use has a commercial nature or a revenue-generating potential (such as farmers’ markets). PPPs can also be used for reconstruction of governmental office buildings, reconstruction and management of sport facilities, and construction and operation of infrastructure.

Practical Application

III.2. Philippine Experience: PPP



Mandaluyong City. As mentioned earlier, a seven-story commercial building with the public market in the ground floor was built for Mandaluyong City after a fire destroyed its old public market. After a public bidding, the contract was awarded to Macro Funders and Development Corporation and was signed on 29 August 1991.

Under the build–transfer arrangement, the new public market was turned over to the city government for its exclusive supervision and control in 1993. It constructed one-half of the stalls inside the market and leased them to market vendors while the remaining stalls were constructed by the stallholders themselves. The city government collects the stall fees and maintains the public market. While ownership of the whole building was transferred to the city government upon completion, the private contractor is managing its operation and maintenance (except for the public market) for 40 years, from December 1994 to December 2034, under a BOT arrangement.

Tenantable areas have been leased to banks, pawnshops, service shops, dry goods stores, restaurants, cinemas, amusement facilities, and other third parties. The rental and other revenues are expected to enable the private contractor to recover the cost of its investment (around \$23 million) and realize a reasonable rate of return¹⁷.

¹⁷ Asian Development Bank. 2016. Philippines: Public–Private Partnerships by Local Government Units. Mandaluyong City: Asian Development Bank. © ADB. <https://www.adb.org/sites/default/files/publication/213606/philippines-ppp-lgus.pdf>.

Directions for Completing Table 1

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

Column 1:

Enter the Cadastre Number, if any, assigned to the real property unit in this column.

Column 2:

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

Column 3:

Enter the survey lot number assigned by the city assessor's office.

Column 4:

Enter the title number as indicated in the certificate of land title.

Column 5:

Enter the tax declaration number.

Column 6:

Enter the current or intended use of the real property unit using one of the following classifications:

Single Use: When the whole real property is occupied or used for one function (for example, City Hall, library, office, or apartments), enter this single use or function.

Choose from the following:

- Public/government/administration
- Pre-schools
- Sport facility
- Residential – Detached single family
- Residential – Multi-family (apartments)
- Retail/service/restaurant
- Office
- Manufacturing/warehouse/distribution
- Parking
- Vacant urban land
- Agriculture
- Other

Multiple (Mixed) Use: When the real property is occupied by more than one type of user or used for more than one function, enter the uses.

An example of mixed use would be where City Hall is used one-half by local government and one-half rented for commercial purposes. In this example, the entry should be “Mixed: City Hall and Commercial”.

Column 7:

Enter the street address, if any. If there is no street address, enter a short description that locates the real property.

Column 8:

Enter the type of real property from the following list:

- Complex of buildings,
- Single building,
- Single building with support structures on real property (e.g. sheds),
- Premises, (use when local government owns only part of the building)
- Vacant land (no Buildings or permanent fixtures),

- Idle land
- Other (specify)

Column 9:

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

Column 10:

Enter the area of land for this parcel in square meters.

Column 11:

Enter the condition of the buildings or facilities. Enter the condition as follows:

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

Column 12:

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

If the building was a former school building with half of the space used for sports and half for music but the sports have been relocated elsewhere, then indicate 50%. When in doubt as to what to indicate, develop a ratio of current use of facility to total area in

square meters. Thus, in our school example, if the building of 6,000 square meters is only using 4,000 square meters, indicate the percentage as a ratio of 4:6 or 67%.

Column 13:

Enter the name and the legal status (i.e., city itself, city budgetary organization, city enterprise, joint stock company, or other) of the legal entity where the real property object is recorded in the balance sheet or other accounting records. If the real property object is not placed on anybody's books, enter the name of the entity controlling it.

Column 14:

Enter the name of the party primarily responsible for the real property management.

Column 15:

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

Column 16:

Enter the date of acquisition.

Column 17

Enter the acquisition cost including the price of property and its related costs.

Column 18:

Enter the Appraised Value

Column 19:

Enter current market value.

Column 20:

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

Column 21

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

Column 22

Enter the amount of financial liens if any associated with this real property unit. In the most typical case, this may be a loan secured by this real property unit.

Column 23

Enter the amount of income or profit generated for the current year.

Column 24

Enter maintenance and operations costs.

Column 25

Enter the remaining economic /useful life of Buildings and Equipment in years.

Column 26

Enter the estimated residual value.

Column 27

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

Column 27 a:

Enter a code that indicates the restitution status of this real property unit. For example, this codification may include such groups as:

- confirmed ownership of the local government;
- confirmed ownership by public institution;
- restitution claim filed and under consideration;
- claims are possible but not yet filed;
- restitution confirmed by court;
- Other.

Codification should cover most typical cases and should be developed by local government lawyers.

APPENDIX 2

ANNUAL REPORT ON PROPERTY ASSET MANAGEMENT

GUIDE ON THE REPORT CONTENT AND STRUCTURE

Introduction to the Guide

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

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

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

Introductory Narrative Review

Summary Portfolio-Level Review

Detailed Property-Level Review

CONTENT OF REPORT

A. INTRODUCTORY NARRATIVE REVIEW

This part may include:

Significant changes and improvements in property asset management: list all substantial regulatory and administrative changes that have happened during the year (such as the adoption of the new Decision on Property Asset Management of the Local government and changes in administering rent collection from business and residential tenants, etc.)

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

Market and economic conditions related to local government property

Overall effectiveness of use of local government real estate. This is a complex topic, and it may take several years of experience to develop a useful analysis of each portfolio and to reflect this analysis in the Annual Report (some thoughts on the analysis of property performance are presented in Annexes 5 and 6). Again, the goal is a brief narrative commentary, with more detail later in the report.

Issues that require attention of the local government or local legislative council.

B. SUMMARY PORTFOLIO-LEVEL REVIEW

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

Properties should be sorted first by ownership (clear, unclear), and then further sorted according to its role in fulfilling the local government responsibilities, as discussed in Activity 3, i.e., mandatory, discretionary (social), and income generating property. They may then be subdivided further according to functional use. The following may serve as an initial list of portfolios, subject to revision as additional experience proves necessary or desirable:

Assets utilized for Mandated Services

- Administrative Property (City Hall, etc.)
- Social Housing
- Pre-Schools
- Sport Facilities
- Market Places
- Other (Miscellaneous) Property

Assets utilized Social and Cultural Services

- Social Housing
- Pre-Schools
- Kindergartens
- Sport Facilities
- Cultural Facilities

Assets utilized for Income Generating Activities

- Office
- Public economic enterprises
- Retail
- Industrial/manufacturing
- Residential
- Vacant/Idle Land (available for construction or other use)

A separate piece on local government's business interests (enterprises) should be included¹⁸.

Note on Identifying and Sorting Properties:

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

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

Key characteristics of each property portfolio, including the number of properties, the Net Income and Cash Flow of each portfolio, and the value of the portfolio. Each "portfolio" should be an aggregation of similar properties such as government-occupied property (i.e., City Hall), types of surplus property, social housing, etc., as noted above.

¹⁸ Details of reporting on business interests are not presented in this Guide.

Total Net Income and Cash Flow earned by all city property for the entire year.

An analysis of the investment performance of the Surplus (Income-Generating) properties. This analysis should address the aggregate Cash Flow and value of each portfolio of similar properties of this class to assist in determining the benefit of retaining them and to assist in identifying those requiring remedial action.

An analysis of the total property-related subsidies offered to NGOs and other tenants of social properties in the form of reduced rent or free occupancy or additional cash or in-kind subsidies aimed for covering property expenses of recipients.

An analysis of the cost of maintaining the social housing portfolio, including the negative Cash Flow and an estimate of the value (appraisal) of this portfolio if it could be sold into the private market as unsubsidized private housing.

Capital transactions such as the purchase, sale, or major improvement of properties. These one-time transactions having implications for the longer term should be reported separately from operating results for any given year. List in a spreadsheet all disposition, acquisition, and financing transactions that occurred with information as follows for each transaction (a sample spreadsheet is shown in Annex 1)

- Asset Number
- Address
- Property type (office, retail, mixed use, apartment, vacant land site, etc.)
- Transaction type (sale, restitution, alienation by a court order, purchase, etc.)
- Net Proceeds if disposed (total less transaction expenses and debt repaid)
- Total Cost if acquired
- Debt incurred
- Comments including reasons for the transaction

Show total Net Proceeds and Total Expenditures from these transactions.

C. DETAILED PROPERTY-LEVEL REVIEW

For analysis and reporting purposes, properties may be sorted and presented by portfolio as follows:

1. Clear Ownership by Local government

- Administrative Property (City Hall, etc.)
- Investment Property (Business and Residential)
- Social Housing
- Pre-Schools
- Sport Facilities
- Cultural Facilities
- Public Economic Enterprises
- Other (Miscellaneous) Property
- Vacant Land (available for construction or other use)

2. Title Unclear/Disputed or Subject to Nationalization or Restitution

- Administrative Property (City Hall, etc.)
- Investment Property (Business and Residential)
- Social Housing
- Pre-Schools
- Sport Facilities
- Cultural Facilities
- Public Economic Enterprises
- Other (Miscellaneous) Property
- Vacant Land (available for construction or other use)

For each property, present key information in a spreadsheet with columns as follows (a sample spreadsheet in Excel is presented in Annex 2):

- Asset Number
- Address
- Category (mandatory, discretionary, surplus)
- Occupancy Percentage (for rental properties)
- Other Indicator of Effectiveness (optional, and may be portfolio-specific)
- Total Income
- Total Expenses
- Net Income (Loss)

- Market Value
- Cash Flow Return [Income Divided by Value as percent (xx.x%)]
- Capital Expenditures
- Recommendation
- Retain
- Sell
- Hold for Restitution
- Hold for Nationalization

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

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

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

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

D. ATTACH THE FOLLOWING FOR EACH ASSET:

Static Non-Transactional Information Report (the content is suggested in Annex 3)
Annual Operating Statement (the content is suggested in Annex 4)

E. GOVERNMENT-OWNED ENTERPRISES

In addition to real estate, governments own interests in business enterprises. Some of these exclusively serve government requirements such as the delivery of utility services. Others serve (or could serve) private clients as well, and others have no direct connection to the provision of city services.

These enterprises may have value depending on the profits they generate or the value of the assets (such as motor vehicles and other equipment) they own. Their value may be enhanced through more effective marketing of their services and through more effective management. The government has an obligation to its citizens to maximize this value. In many ways, the management of these assets is similar to the management of real estate. Revenues must be increased (consistent with the need to provide public services) and costs must be controlled.

If the enterprise also serves private customers or has competition in the private market, its managers should consider the benefits of privatization. Experience demonstrates that, as a general rule, private owners operate enterprises more efficiently than do government employees. Further, government competition against the enterprises of its own citizens may be (or appear to be) unfair.

This Manual is not intended to go into deep detail concerning the management of such enterprises. However, it is important that they be monitored and that their managers take advantage of every opportunity to improve their importance. An annual report could include the following information:

- Operating Statement (similar in format to that of real estate)
- Balance Sheet listing assets and liabilities and their values/amounts
- Identification of management personnel
- Discussion of operations
- Discussion of any planned major capital investments
- Discussion of potential for privatization

- Estimate of fair market value if privatization is possible

As with real estate, the management of an enterprise requires great judgment and cannot be carried out simply by following a formula. Difficult decisions must be made, and foresight is required. But the results can be improved efficiency and better service to citizens.

ANNEXES

Annex 1: Asset Management - Real Estate Transactions

Asset Management - Real Estate Transactions
(Excel chart)

Annex 2: Asset Management - Real Estate Holdings

Asset Management - Real Estate Holdings
(Excel chart)

Annex 3: Static Non-Transactional Information Report

STATIC NON-TRANSACTIONAL INFORMATION REPORT

General Information

Date of Review

Asset Number

Asset Manager (person)

Property Address

Street Name and Number

City

Zone

Property Type

(Apartment, House, Office, Warehouse,
Parking Lot, Vacant Land, Retail
store/service, etc.)

Entity on whose balance sheet the property
is kept

Restitution Status

Reason for Retention

(i.e., local government occupancy, income,
legal requirement, or other)

Category of Function (classification)

Property Manager

Company Name

Manager (person) Name

Address

Telephone

Fax

Email address

Building Size (Square Meters)

Land Area (Square Meters)

Physical Description

(Text; i.e., Three story building containing
office premises on upper floors and four retail
shops on the ground floor.)

Tenant Roster

Premise Number	Tenant Name	Area M2	Monthly Rent	Lease in Expiration	Estimated Compliance (Y/N)	Level of Use By Tenant (%)
----------------	-------------	---------	--------------	---------------------	----------------------------	----------------------------

Inspection Data

Date Inspected by Asset
Manager

General Condition (text with
photos and completed checklist)

Necessary Repairs and Cost
Estimate

Capital Improvements Required*(Description of Needed Improvements)***Justification (Review of benefits or additional returns to be produced and/or consequences of not making improvements)**

Estimated Cost

Proposed Commencement Date
for Work**Appraisal or Informal Estimate of Value (Maintain historical record)**

Appraised Value

Date of Appraisal

Name of Appraiser

Purpose of Appraisal
(For example, to update record of
fair market value, for guidance in
sale, etc.)**Encumbrances (Debt)**

Initial Debt

Current Amount of Debt

Interest Rate (%)

Monthly Payment Amount

Final Due Date

Comments*(Narrative describing any additional important information such as variable rate)***Insurance Information**

Type of Coverage

Amount of Coverage

Expiration

Agent

Name

Address

Telephone Number

Insurance Company

Communal Fee

(annual or monthly)

Completed by: _____

Asset Manager

Date: _____

Approved by: _____

Asset Management Head

Date: _____

Annex 4: Annual Operating Statement

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

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

Property Address and Other Identification Data			
Revenues	Current Month	Year To Date	Annual Plan
Rent			
Reserves (collected from tenant from which manager pays certain expenses as provided in Lease)			
Parking			
Late Charges			
Rooftop Antenna Fees			
Concession Fees (i.e., vending machines)			
Other/Miscellaneous			
Total Revenues (Sum of above)			
Expenses			
Building Repairs (on-going small repair)			
Parking Lot Repairs			
Supplies (light bulbs, trash bags, etc.)			
Landscaping			
Gas/Heating			
Electricity			
Water			
Janitorial/Cleaning			
Garbage Removal/Hauling			
Insurance			
Taxes/Communal Fees			
Management Fees			
Legal Fees (rent collection, eviction, etc.)			
Interest on property debt			
Miscellaneous			
Total Expense Sum of above)			
Net Income (Total Income minus Total Expenses)			
Capital Expenditures			

Annex 5: Indicators

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

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

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

INDICATORS FOR INVESTMENT PROPERTY

Occupancy

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

$$\text{Vacancy} = 100\% - \text{Occupancy}$$

Managers of rental properties measure occupancy in two ways.

Method 1

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

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

Method 2

A less common way to measure occupancy is by rental amount. This reflects the fact that a vacancy in a property capable of generating high rent represents a greater loss than a vacancy in a less valuable property. It requires estimating the rental potential of vacant property as well as considering the actual rent being collected on leased property.

For example, if actual rent on a property is being collected at the rate of Php 9,000 per month and the estimated rent on vacant space in the property is estimated to be Php 1,000 per month, the property is estimated to have a rental potential of Php 10,000 per month, and is ninety percent (90%) occupied. Of a total rent potential of Php10,000, only Php 9,000 are being collected.

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

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

Finally, a total occupancy of all properties would be calculated. It is acceptable to report separate occupancy percentages for residential properties and for business properties because of the common practice of measuring apartment occupancy by the number of

units rather than floor area and the related difficulty of consolidating business property (square meters) and apartments (number of units).

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

Return on Investment

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

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

It is important to recognize that the net income in a given period may not be representative of the potential performance of the property. For example, a property in poor condition and undergoing renovation to make it suitable for occupancy may have no rental income and in fact may have expenses such as water fees and electric fees. The resulting loss could suggest that the property is worthless. A “return on investment” for such a property is not relevant, unless one considers the potential net income after the renovation is complete.

Likewise, the income on a fully rented property may be deceptively high. Most properties over time experience vacancy and/or collection problems, and it is unrealistic to make investment decisions based on returns that may not be typical of the longer term.

If the property is subject to debt such as mortgage financing, then it is important to be careful in calculating the return on investment. It can be calculated in two ways. First, the income before deducting interest on the debt divided by the value of the asset is very useful in evaluating the performance of the property. (The performance of the asset is not changed by financing. The rents and operating costs will be the same with

or without debt.) Second, the return after deducting the interest cost divided by the value of the equity (the value of the asset minus the amount of the debt, not the value of the property alone) shows the performance of the investment.

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

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

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

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

INDICATORS FOR ALL TYPES OF PROPERTY

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

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

Operating Analysis

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

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

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

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

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

Deferred Maintenance

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

Portfolio Composition

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

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

Data Sharing

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

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

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

Conclusion

These are measures that asset managers find useful. As the asset management process evolves, managers themselves will find additional ways to measure the performance of their portfolios according to the unique composition of those portfolios.

Annex 6: Sport Facilities

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

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

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

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

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

The local government should expect benefits for incurring these expenses. Because investment income is not the goal, there must be other benefits associated with the asset. In fact, those benefits are received in the form of recreational opportunities for

the community. While everyone will not participate in recreation, some will. The local government must determine how many citizens make use of the facility. Then, a cost per user can be determined.

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

If every citizen does not have a reasonable opportunity to use the facility, then its value to the community must be questioned. The local government should resist making it available only to the elite few athletes who can qualify competitively for a team but rather should be sure that all citizens have the opportunity regardless of athletic ability. Of course, competitive teams should have the opportunity to use the facility, but their use should not be exclusive of other citizens. If the objective is to limit use only to those with exceptional ability (either exclusively or for most reasonable hours of operation), then the local government should consider requiring the users to pay all costs including a rent comparable to the return from other investment opportunities.

If in fact a facility is available to all citizens, then every effort should be made to control expenses consistent with good management practices, to generate revenues from food concessions, etc., and to promote use as widely as possible.

As costs per user are studied, it may become apparent that certain facilities cost more than others to support. This may lead to the decision to close, sell, improve, or otherwise act to improve the benefits to the local government of owning the asset.

Annex 7: Guide in Building Effective Asset Management

No.	Title of Activity	Brief Description	Recommendations for Implementation	Sample Procedures

Note: *Specific activities will be developed by the Asset Management Specialist*

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