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MEMORANDUM

August 6, 1992

To: Michael Murphy, ICMA

From: Lynne B. Sagalyn (Through Tom Kingsley)

Subject: MEMORANDUM ON TRIP REPORT ON PROGRESS AND ASSISTANCE PROVIDED

Ref: RFS 06, Tasks 1 and 4, Local Government and Housing Privatization Contract, Contract No. EUR-0034-C-00-2034-00, AID Project No. 180-0034 (UI#6283), Prepared for Regional Housing and Urban Development Office, Eastern Europe (RHUDO/EE).

Copies: Morton Grant, Carlotta Molitor

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The attached materials constitute the report on the July trip concerning the Strategic Land Development Agenda. Fulfilling the requirements of the above-referenced tasks, they include an outline of the seminar presentation on land disposition strategies and a summary of work program ideas. Please call Tom Kingsley if you have questions. We hope you will be able to submit this deliverable to AID as soon as possible.

**SEMINAR ON MUNICIPAL LAND DISPOSITION:
STRATEGIES, RATIONALES AND POLICY**

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Prepared for Municipal Officials, City of Prague
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Prague, CSFR

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**SEMINAR ON MUNICIPAL LAND DISPOSITION:
STRATEGIES, RATIONALES AND POLICY**

Outline of Topics

Focus: How to think about strategies for land disposition in a market-based system of private development which is carried out under public regulatory control.

- I. Summary of Key Points
- II. The Financial and Economic Aspects of Sale versus Lease Disposition
- III. Leasing versus Sale Policy Rationales: The US Experience
- IV. The New Set of Skills Needed at the Municipal Level

I. Summary of Key Points

1. The decision to sell or lease land is a long-term decision about ownership, not development. These decisions are not the same, though they may be linked. For example,

a) A municipality's decision to develop a parcel with a private entity through a public-private venture will most likely involve a land lease, but the converse is not true: A lease of land to a private entity would not necessarily involve a municipality in active development of that land.

b) Similarly, regardless of the sale or lease decision, building construction is subject to uniform land-use (zoning, building code) regulations and procedures as specified under existing law. As landowner, however, a municipality can impose additional development requirements specific to the parcel under consideration; the mechanisms for doing so will differ with a sale or lease disposition.

2. Land values -- whether disposition is by sale or lease -- are determined by the "market" through the price bids developers and investors are willing to make for land and buildings. The terms and conditions of those bids, however, can be set by a municipal landowner in its disposition offering statement (RFP) and through the process of negotiating the detailed business terms of a deal with the private entity selected to develop a parcel.

3. In a market-based system, a municipality is only one of many players -- one supplier in competition with others. While it might be the largest single land holder, it is not the only. As a consequence, it cannot arbitrarily set prices at what it "wants" and expect to have them met unless those prices (and terms) are competitive with what others in the market are offering. If the prices set are too high or if a municipality's terms of disposition make private development infeasible, the land is unlikely to attract much developer interest.

Developers will choose the path of least resistance: For a municipality's parcel to have a competitive advantage in the marketplace, it has to be priced right, or be in an attractive location, or come with administrative aid to ease the project through time-consuming bureaucratic approvals processes.

4. From a developer's perspective, the price he (she) is willing to pay is determined by its income-producing potential which, in turn, is a function of the use (office, hotel, residential, retail, industrial) and its density (amount of leasable space) permitted under regulatory controls.

5. Leasing is attractive to private developers for several reasons:

a) No large outlays of cash are required for land acquisition in the critical, early years of developing a project.

b) As long as the lease term is relatively long (75 years +), there is long-term control over the property.

c) In the US, leasing is advantageous from a federal income tax perspective.

d) In the CSFR, approval by the Ministry of Finance is not required for a lease transactions with foreign investors as is the case with a sale transaction.

A significant disadvantage to leasing, in the US at least, is that mortgage financing for the structure(s) to be built on that land is harder to get and often more costly as this type of financing (leasehold mortgage) is considered more risky.

6. Whether a sale or lease will bring the municipality more money (over the length of the lease) is a difficult generalization to make. For any particular parcel that assessment depends on several factors; among them, market conditions, the pricing of a particular deal, the risks the municipality as land lessor (owner) may take in order to encourage a certain type of project.

7. The decision to lease or sell land is a policy decision, and it is one that need not -- probably should not -- be applied uniformly across all municipal lands and property. Why?

a) Leasing transactions are costly (involving a lot of legal work), cumbersome, and time consuming, especially when municipalities use them to aggressively control development. Not all kinds of land or property can justify the large expenditures of financial and personnel resources.

b) The most effective way for a municipality to begin to think about its land and property resources is to inventory those assets for strategic purposes.

Identify broad policy-relevant categories of land, for example:

- prime commercial development parcels,
- housing parcels,
- land for parks and open space,
- miscellaneous small parcels that abut existing privately owned lands and, as a result, are not really feasible for development.

Then, design land disposition policy and strategy around different objectives for such lands.

II. The Financial and Economic Aspects of Sale versus Lease Disposition of Land Assets

A. Timing of the revenue returns -- lump-sum payment for transfer of title (sale) versus annual rental payments for occupancy/use over time (leasing)

B. Different Components of the Lease Revenue Stream

1. base rent
2. inflation adjustment
3. performance-based return (profit-sharing)

At the end of the lease term, buildings revert to land owner.

C. Different Risks

1. Sale -- loss of potential increases in future value coming from public investments in infrastructure
2. Lease -- financial risk of project's economic failure and resulting inability of developer/investor to pay contractual rent; legal and litigation costs

D. Issues to Consider in Structuring a Lease

1. Price
 - a) setting a minimum price
 - b) designing a structure of payments
2. Conditions
 - a) term (length of lease)
 - b) subordination/nonsubordination of land to financing for the building(s)
 - c) parcel-specific restrictions on use
 - d) affirmative obligations of lessee to provide infrastructure, public amenities, maintenance
3. Legal Framework (model lease in RFP, security, rights of assignment)

III. Leasing versus Sale Policy Rationales: The US Experience

A. Sale (the conventional model in the US)

1. No overriding public interest for retaining land asset -- in general, land belongs in private hands (and on the property tax roles).
2. Municipality has an immediate need for revenue to close a budget gap and the potential dollars from a sale of surplus assets are big: example -- City of Boston's sale of downtown parking garages in the mid-1980s.

B. Leasing (a trend in big cities in the 1980s)

1. Overriding public interest in retaining long-term ownership of land or buildings: example -- historic sites and structures such as Boston's Faneuil Hall markets; submerged lands and waterfront properties.
2. Sites of strategic importance to the control and delivery of government services: example -- land adjacent to or air-rights over mass transit stations.
3. Strong land market and a city aggressively seeking to capture the financial benefits of long-term land ownership by using the land lease as a means of controlling large-scale development for public gain: example -- Los Angeles' California Plaza project and its package of public returns (revenues, museum, open space).
4. Current market conditions in key locations very uncertain -- if sell now municipality may lose substantial value which could be captured through a carefully structured lease arrangement.
5. Institutional motivation -- the agency which owns the land can better control use of disposition revenues through leasing rather than sale because a sale would force it to turn over cash proceeds to municipal general treasury
6. leasing as an aid for economic development -- leasing land is a form of financing for developers and thus a way for municipality to use its resources to stimulate certain kinds of desired development with below-market pricing.

IV. The New Set of Skills Needed at the Municipal Level

A. Technical Skills of real estate analysis

1. market feasibility
2. projection of development costs, project income and expense budgeting (pro forma analysis)
3. evaluation of developer responses to municipal RFPs (Requests for Proposals)

B. Entrepreneurial Attitudes

C. Design of Strategies for Municipal Land Disposition

DATE: 13 July 1992
TO: Tom Kingsley
FROM: Lynne B. Sagalyn 
RE: Some outline notes for our telephone conversation on
TA/Land Development in CSFR, week of 14 July

A key organizing element for a TA program in strategic management of land development for Eastern Europe is the need to provide different types of advice (big-picture policy as well as concrete, technical skills) and information on a range of topics to different types of change agents (municipal decision-makers, technical staff, professional educators, lawyers and other real estate professionals). A second is the need to balance the provision of assistance for short-term tasks or immediate problems with teaching and systems development for building long-term municipality capacity in this area. [See Attachment 1, "Objectives."] Accordingly, I think our TA program should be designed and structured for three different levels of implementation where transition and change are now taking place:

(1) **Policy or Strategic Decision-Making** -- involving the appropriate Ministry (ies) (where new enabling legislation may be required to facilitate local land-use regulation and land disposition/development of publicly owned property), key municipal decision-makers (mayor, deputy mayor), and umbrella municipal organizations (UTC, ACT);

(2) **Public Management Procedures and Processes Supporting Municipalities' Redefined Roles** -- including approvals procedures for private land development, citizen-participation processes, land-use regulations, and technical skills and procedures for managing the development and disposition of publicly owned land;

(3) **Specific Project or Program Implementation** -- for example, Prague 6 assistance for the Victory Square project.

In terms of our TA program, this orientation means that courses and/or training modules would be targeted to meet the needs of different audiences (agents of change) rather than designed around different topics (the ICMA model for housing in Poland). For example, we might run a 3-day seminar for high-level public officials (deputy mayors, chief architects) in which we covered policy development, strategic decision-making, and specific skills in public-private joint ventures using a combination of lectures, case discussions, and expert panels. In

terms of meeting the capacity-building objective, a very different seminar would be designed for staff-level persons (and educators) to teach the new set of technical skills (feasibility studies, pro-forma financial analysis for development-project review, demographics (planning) data collection and projection, design approval review, etc.) needed to implement local government's redefined role in a market-based system of private development.

ATTACHMENT 1

TA OBJECTIVES: STRATEGIC MANAGEMENT OF LAND DEVELOPMENT

(1) to provide a policy framework for local management of land development in a market-based economy, including an understanding of:

a) the strategies and tools of land-use regulation and nonregulatory roles of municipal government based on the US experience;

b) institutional arrangements for managing the process and financing of land development in a multi-level governmental system;

c) the connections between policy tools, governance structures, and intergovernmental fiscal relationships.

(2) to offer practical advice on how to deal with private developers and implement municipally initiated development projects;

(3) to put in place capacity-building systems (technical skills, inventory system for managing publicly owned land, information collection and dissemination, citizen-participation processes) within local municipal offices for facilitating public review and control of private development.