OUTSOURCING OF REAL ESTATE MANAGEMENT AND DEVELOPMENT IN THE PUBLIC SECTOR

Patrick J. Moynihan, Richard A. Flier, Clare C. Conley, and Lisa McCallum

THE PROBLEM

Public sector entities are often large landowners, yet they seldom allocate sufficient resources to manage their properties effectively as assets. The Massachusetts Executive Office of Transportation and Construction (EOTC), Massachusetts Highway Department (MHD),[1] Massachusetts Turnpike Authority, and Massachusetts Port Authority (Massport)—all public sector entities with a transportation mission—are some of the Commonwealth's largest landowners. The Massachusetts Bay Transportation Authority (MBTA) has been ranked the second largest landowner in Massachusetts, after the Commonwealth itself. Trends toward downsizing and budget tightening have resulted in layoffs, reorganizations, and the reallocation of resources to these agencies' primary functions (i.e., the movement of goods and people); real estate activities are given very low priority. Management of the properties is often ineffective, and the agencies forego potential revenues. The MBTA began focusing on this issue in earnest in the early 1990s.

The MBTA operates one of the largest transit and commuter rail systems in the United States and employs approximately 6,300 people. The multi-modal authority provides electric trolley, bus, subway, paratransit, commuter rail, and commuter boat services in 98 cities and towns throughout eastern Massachusetts. For years dubbed a "budget buster," the MBTA's total operating costs peaked in fiscal year 1994 at $578 million. In 1992, a new administration took over at EOTC and the MBTA—James J. Kerasiotes as Secretary of Transportation and Chairman of the MBTA and, in September of 1995, Patrick Moynihan as General Manager of the MBTA.[2] Under former Governor Weld's direction, a major goal of this administration was to reduce dependence on state assistance through competitive contracting of operating and management functions and implementation of cost control measures and efficiencies. Through the efforts of Kerasiotes and Moynihan, the MBTA's annual operating expenses declined by more than $100 million between 1994 and 1996 due to reductions in controllable costs.[3]

While the MBTA had contracted for cleaning services in transit stations and the like, it had not expanded competitive contracting to larger departments until the MBTA real estate department was targeted by Kerasiotes and Moynihan as a potential candidate for outsourcing. The MBTA real estate department was comprised of about 25 employees headed by a director and assistant director. Key functions of the department included managing all leases for MBTA properties, maintaining the tenant ledger, collecting rents, negotiating master lease agreements on larger facilities (e.g., South Station), selling surplus properties, and responding to joint development opportunities presented by private developers. A separate group for acquisition of rights of way for new commuter rail lines was also housed within the department. Management of certain advertising and parking management agreements was outside the department's purview.

In addition to direct personnel, the office was supported by several attorneys in the law department, for contract and lease reviews, and by the revenue department for generation of receivable lists and tenant billings. The cost of

[1] Both the MBTA and MHD are encompassed within EOTC, but their operations are significantly different both from each other and from EOTC, and, as a result, their real estate functions are described separately.

[2] Mr. Kerasiotes resigned as Secretary of Transportation in July of 1997 and is currently Chairman of the Massachusetts Turnpike Authority. Mr. Moynihan succeeded Mr. Kerasiotes as Secretary of EOTC and Chairman of the Board of the MBTA.

[3] Cost reduction information contained within this paper has been provided by the MBTA.

these functions to the MBTA was approximately $1.5 million per year, while the revenue generated averaged about $3.5 to $4 million per year, exclusive of any proceeds from property sales.

In 1993, in order to address perceived weaknesses in the department's operations, the MBTA engaged the accounting firm of Kenneth Leventhal & Company, Boston, a national CPA firm specializing in real estate, to perform an organizational diagnostic review of the department. Numerous recommendations were made by the consultant, with special emphasis on the accuracy of the tenant ledger, collections, and lease management. A new director was hired to manage the real estate department and was provided with these recommendations. Despite the new director's best efforts, many problems were not addressed in time frames and with results deemed sufficient to management. The real estate department remained unable to garner and maintain the resources needed to respond to market opportunities.

In anticipation of the outsourcing initiative and in response to internal deficiencies, Ernst & Young/Kenneth Leventhal Real Estate (E&Y/KL) Consulting was hired to perform a review of the tenant ledger. E&Y/KL offered the following report on the more than 800 accounts managed by the real estate department in 1995:

∞ Eighty percent of the leases were underperforming, either from failure to apply consumer price index escalation clauses or from other lease management oversights.

∞ One lease had not been adjusted since its execution in 1906, and more than 190 agreements had not been updated for 50 years.

∞ Over 50 agreements were still on the books with rental rates of $1 to $5 per year, and more than 145 were billed for less than $20 per year.

∞ A large percentage of the leases had not been renegotiated since 1980 and were tenants at will.[4]

∞ More than 100 agreements were inactive but had not been removed from the billing system.

∞ Of the more than 260 agreements not on file with the real estate department, 80 could not be found within any of the authority's files.

∞ Supporting documentation for billings against agreements was spotty.

∞ Rental invoices were issued anywhere from a month to two months after rent was due.[5]

In addition, the real estate department was generally reactive to requests to lease or purchase MBTA property rather than strategic and proactive. This was a department in crisis—the fundamental elements of real estate asset management, that is, identification of the assets to be managed; analysis of the market context within which those assets may be categorized and evaluated; control, maintenance, and management of the records and documents (title and lease/license data) related to the assets; and a strategic long-term program for marketing, leasing, development, and selling properties, were missing from the MBTA's real estate management/development program.

This approach to real estate management entails, in addition to opportunity costs, those costs associated with 1) redundant work efforts, due to lack of reporting and document management systems; 2) inefficiencies due to lack of advanced real estate management technology systems (e.g., geographic information systems); 3) other MBTA staff resources and consultant payments for survey and title work to determine land ownership and value; and 4) failure to integrate the real estate function with the operations function in a manner that adds value to both.

The MBTA has historically realized one of the highest levels of real estate revenue among transit authorities nationwide.[6] However, significant revenue opportunities have been missed by 1) failure to recognize and/or capture market opportunities as they arise; 2) failure to develop and implement strategic disposition programs; and 3) failure to identify, in the context of a strategic disposition plan, the impact of a minor

---

[4] A "Tenant at Will" is technically defined as "[o]ne who holds possession of premises by permission of owner or landlord, but without any fixed term.…Also called 'month-to-month' tenancy." *Black's Law Dictionary* 764 (abr. 5th ed. 1983). In the context of this paper, however, the term refers to any tenant or licensee whose agreement is or was for a period of less than one year (typically a license agreement) or had expired and is now subject to termination upon 30 days notice.

[5] MBTA submittal to Office of the State Auditor, April 1996, subsequently confirmed and updated by TRA.

[6] "Massachusetts Bay Transportation Authority Real Estate Function: Organizational and Operations Diagnostic Review," study prepared by Kenneth Leventhal & Company, August 1993.

transaction on a larger transaction. Revenue enhancement efforts were also seriously hampered by the number of departments and decision makers involved in the real estate program, and by the lack of a centralized organizational structure for maintaining and managing documents (such as leases and title information) and historical data related to the property. Lack of a well-coordinated leasing strategy, timely responses from relevant staff, and expeditious legal action can result in the loss of thousands of dollars a month. For example, if a retail lease is not executed promptly, or build-out plans reviewed in a timely fashion, the vacancy at just one retail location can result in a $5,000/month loss to the MBTA.

Total lost revenues to the MBTA over time are extremely difficult to measure in the absence of historical data, but proposed transactions reviewed over the past year indicate that the lost revenues may well have been in the millions of dollars.

The Solution

In response to Kerasiotes' call to infuse competition into the provision of services, MBTA management reorganized an existing department into a program development and outsourcing department, directed by William Steffens, in mid–1995. The real estate function of the MBTA was a clear candidate for outsourcing: 1) the function was not a core area of the MBTA's business; 2) the function was not being performed at the standards required by the organization; 3) there were significant costs associated with the performance of this function; and 4) a number of established private sector companies in the area were in the business of performing asset management, disposition, and joint development activities.

In October 1995, General Manager Moynihan hired a new deputy chief of staff, Lisa McCallum, whose main functions related to outsourcing initiatives. Upon her arrival, Ms. McCallum created a steering committee comprised of representatives from relevant departments, including legal, labor relations, real estate, planning and operations, and contract administration, to pursue the competitive contracting of the real estate functions. While the steering committee met on policy issues, a technical committee of staff met to assemble and review draft material.

The MBTA also engaged a consultant, Cityscope Realty Advisors, to assist with drafting the Request for Proposals (RFP), help document the process for the Office of the State Auditor pursuant to the Commonwealth's privatization law, and provide support during the transition process. In order to draft the RFP, Cityscope conducted internal interviews to identify the department's actual activities and performance, clarify the expectations of the MBTA for performance enhancement, and develop the standards to be applied to the successful bidder. Cityscope also interviewed prospective respondents to the RFP, to determine how to ensure the most benefit to the MBTA while generating the most interest—and competition—from the private sector.

Because the department's reputation was less than sterling in the industry, and because the industry perceived that the MBTA's property and leases could not generate cash flow sufficient to attract a professional management company, the MBTA outsourcing team realized that some financial incentive would be required to attract strong bidders. From Cityscope's study emerged the following criteria:

∞ The activities to be outsourced should be as precisely defined and quantified as possible.

∞ An incentive-based fee structure would be required to attract competitive bids.

∞ Opportunity for significant financial gain would be necessary for the contractor to assume the administrative burden of rectifying problems with the tenant ledger and carrying out the base asset management functions.

∞ A relatively long term for the contract would help offset the initial investment of senior management time and the related administrative burden.

The Contract

<u>Contract Specifications</u>: The RFP initially included all the functions performed in the real estate department. As the process unfolded, it became clear that certain functions were unique to the MBTA and probably not conducive to precise definition, such as acquisitions related to development of transportation rights of way. The team determined that acquisitions would be dif-

ficult to bid on and eliminated this function from the RFP—right-of-way acquisition staff were reorganized as part of another MBTA department.

Incentive-based Fee Structure: In order to capitalize on the profit motive—an incentive not generally recognized in the public sector and a main advantage in outsourcing this function—the RFP encouraged proposals with incentive-based compensation structures for the contractor. Such compensation would include a fixed base management fee for the existing lease and other income, plus a percentage of any revenue increases over that base. While the RFP was not explicit about the fee structure, the compensation structure was known to be a major factor in evaluating the proposals.

Compensation for Administrative Burdens—Parking Garage/Joint Development: The dismal results of the 1995 tenant ledger audit underscored the challenges of taking over the lease management function. Management fees as a percentage of existing revenue streams were perceived as insufficient compensation to bring the management function up to professional private industry standards. From interviews with MBTA staff, Cityscope determined that the authority needed a large number of parking spaces to satisfy both commuter-rail user demand and the MBTA's legal commitments to construct 20,000 new spaces over 10 years as part of mitigation related to the construction of Boston's new Central Artery. Following strenuous debate on the merits of a design-build-manage construction program within the constraints of the Massachusetts bidding laws, the MBTA concluded that the "carrot" in soliciting private sector interest would be a construction program of 5,000 parking spaces.[7] The RFP therefore requested that the bidder/contractor propose how this program could be funded with minimal public commitments. The contractor's team had to include large-scale design and construction capabilities, and bidders were evaluated for those capabilities as part of the selection process. Ultimately, the contractor was made the exclusive designer, developer, and manager of the authority's new parking garages, subject only to certain explicit exclusions, until at least 5,000 additional parking spaces were under construction. This provision ensured that, when and if funding could be made available by either the MBTA or the contractor, the parking program would move forward.

Longer Term for the Contract: The MBTA initially contemplated a three-year contract. However, a three-year term was deemed insufficient to allow the contractor to gain control of the numerous functions and construct the parking facilities. Because regulations in the Commonwealth limit contracts related to outsourcing, the MBTA chose to set the contract term at the maximum allowable five years.

A Single Contractor vs. Multiple Contractors: It had been suggested that the MBTA might achieve better efficiencies and revenues from its real estate if different parts of the system and/or types of real estate activities were managed by different contractors. Intuitively, this suggestion makes sense, since it appears to encourage even more competition. In reality, it would serve to add layers of bureaucracy and confusion within the organization and would probably not result in improved efficiency or revenue.

Many transactions must be vetted through multiple MBTA departments, all of whom have priorities that are wholly unrelated to real estate. As many as five or six departments, and multiple staff within each department, may have a legitimate interest in any given real estate transaction. (Coordination between departments becomes extremely difficult when reorganizations take place, as has happened several times within the past 18 months at the MBTA.) If MBTA staff had to deal with real estate requests coming from a variety of "designated MBTA representatives," transactions would likely become bogged down and real estate priorities would begin to compete with each other as well as with transportation priorities within the organization. The MBTA would realize an additional administrative burden of managing more contracts and contractors, and dealing with the personal and corporate styles of each—including different types of reporting, different types of documents, etc.

[7] At the time of the RFP, the authority worked out a general approach to fund the program, but funds were not committed at that time. Therefore, the program was conditioned on funds becoming available, and the RFP requested that the bidder/contractor propose ways to fund this program with minimal public commitments.

Third parties seeking to do business with the MBTA need a single proponent to move projects along and a single point of contact to ensure follow-up. Multiple real estate contractors would inhibit the efficiency of moving projects through the MBTA, particularly in the case of system-wide programs such as wireless telecommunications, certain utility agreements, payphone agreements, and similar types of activities that need to be addressed at a number of levels within the organization. For these reasons, the MBTA determined that a single contractor should be selected to carry out the real estate functions of the authority.

<u>High Level of Independence, with MBTA Oversight:</u> The contract anticipated a relatively high level of independent action, by providing that TRA would have the "right and obligation" to perform the contract services, including negotiation, execution, and delivery of virtually all agreements relating to the properties (leases, licenses, amendments, etc.). This right, however, is subject to MBTA oversight and must be consistent with certain policy and operating guidelines.

<u>Contractor Selection and Contract Negotiation</u>: In response to the RFP, the MBTA received three bids from outside contractors and one bid from an affected union. Because the authority had a history of negotiating leases with real estate firms in which, after the fact, external review suggested that the authority received less than full value, the MBTA engaged the Boston real estate firm Avalon Partners to represent the authority in contract negotiations—especially with regard to the commission structures. In addition, the MBTA retained McDermott, Will & Emery, an internationally known law firm with privatization expertise, to draft the contract and otherwise augment the MBTA law department's limited capacity to undertake such an intense effort over a relatively short time period.

Transit Realty Associates, LLC, a consortium of A. W. Perry Management Corp., Farmer & Flier, Development Services Group, K.C. Donnelly, Inc., and Engineers Design Group, was selected as the successful bidder. The team included Sandy Beal, Jack Spurr, and Buzz Constable of A. W. Perry; Neil Farmer and Richard Flier of Farmer & Flier Partnership; Douglas Herberich of Development Services Group; Jane Donnelly of K.C. Donnelly, Inc.; and Thomas Arthur of Engineers Design Group. The team was selected because of the its broad experience in property management; real estate (including retail) development; valuation; brokerage; and parking garage design, construction, and management. The team's commitment to quality and performance, minority participation in real estate opportunities, and enhancement of the ridership experience; its responsiveness to issues of concern to local communities; and the level of DBE (Disadvantaged Business Enterprise) participation were also key factors in the selection.

Once TRA was designated the winning bidder, negotiations began in earnest. The fee structure was agreed upon, with a fixed fee of approximately $1.1 million per year including lease management and collections, drafting and execution of new lease or license agreements, development of a joint development strategy, and preparation of a (non-automated) parcel ownership inventory management/strategy.

Additional fees over the base fee were spelled out in the final contract: these included industry-standard brokerage fees related to execution of sales and new leases; management and value creation fees for revenue produced and value created by MBTA joint development projects; consulting fees for the development of a computer-automated parcel ownership database; a lump sum fee for a parking feasibility study (preliminary to the parking construction program); and fees related to the design, construction, and management of parking garages. The governing principal was to provide incentive to the contractor by creating fees as a percentage of revenue enhancement through sales and leases or other value creation, while the authority garnered the preponderance of that value. For example, the contractor is entitled to standard brokerage fees for sales and leasing activities, and compensation is provided for other value creation under joint development activities and the parking garage program. In each case, fees are tied to revenues, cost savings, or other value realized (and actually achieved) by the MBTA. These fees, which represent a small portion of the value created, are generally paid through transaction revenue or by third parties (e.g., developers).

Contract Implementation

Upon award of the MBTA contract, TRA principals interviewed all members of the existing MBTA real estate department and evaluated each of them in the context of the positions and qualifications outlined in the company's preliminary work plan, including the ability to work as part of a team. Offers of employment were made to seven members of the real estate department; six accepted, and one initially accepted but decided to return to the MBTA to work in another department. The principals also reviewed resumes and conducted a series of interviews with a number of highly qualified members of the real estate community. The principals selected Clare Conley, previously the Manager of Leasing and Asset Management for port properties at Massport, to become the Chief Operating Officer of the company. Operations began as the interviewing and staffing process continued.

The Services Agreement contemplated a three-month period as the "transition phase" from MBTA management to contractor management; due to timing constraints, this transition phase was squeezed into one month:

∞ Offices were established in Winthrop Square on July 29, 1996, and, within the next few weeks, TRA staff and principals packed and arranged for the transfer of more than 200 boxes of files, plans, and related documents from the State Transportation Building. File consolidation and file management began immediately.

∞ A list of approximately 200 active license, lease, sale, easement, joint development, and other miscellaneous projects (in addition to the parking garage projects under review) was created, as well as project profiling and tracking systems to manage and prioritize matters for action.

∞ Preliminary data entry of tenants and leases was completed to match the MBTA's accounting records. TRA issued August rental and fee invoices by August 1, collected $878,000 in total receipts during August, and issued September invoices by August 29.

∞ TRA secured execution of the first retail/concession lease to be executed in over 15 months and positioned three additional retail/concession leases for execution in September. Total MBTA revenues secured from these four lease transactions were $1 million over 5 years.

∞ TRA and MBTA began meeting on a weekly basis to establish a set of operating guidelines satisfactory to the authority—these guidelines essentially laid out the procedures by which TRA would coordinate with and gain approval of transactions by the MBTA.

Given the volume and condition of the files transported to TRA's offices (almost twice as many as predicted by the MBTA and in a condition similar to the lease files), Transit Realty staff and principals were immediately concerned with document and project management. With 200 apparently active projects as of the date of performance commencement, new requests arriving on a daily basis, and multiple processes required by MBTA policies and statutory constraints in order to execute a transaction, TRA realized that sophisticated property inventory, project management, and information management/reporting systems were not simply desirable but critical to the success of the contract.

TRA also realized that in order to achieve the dual goals of the contract—achieving demonstrable results and establishing systems for accountability—the company would need to be both efficient and persistent. The fine line between independent action and cooperation between the "partners" in this private/public partnership quickly became evident, as TRA was startled by the review and approval processes required by the MBTA, and MBTA staff were aghast at Transit Realty's persistent requests for more independence in moving projects forward. The gulf between private sector and public sector experiences and expectations was fully revealed during the first three months, as both TRA and MBTA staff worked to establish the functional ground rules for transaction activities.

Contract Services

The TRA/MBTA contract requires that TRA provide base asset management services; develop and maintain a comprehensive property inventory; identify and sell or lease surplus properties; develop and implement a strategy for joint development of authority property; and develop and implement a parking garage program that would create up to 5,000 new structured parking spaces within the MBTA system.

Asset Management

In the context of real estate leasing and management activities, the term "asset management" refers to "the process of overseeing the management functions associated with an item of value to ensure the goals of its owners are achieved."[8] In the case of the MBTA, which owns a wide variety of land throughout the Commonwealth and has an evolving understanding of the goals it wishes to achieve through its real property assets, these management functions are quite complex. First and foremost, the authority's transportation operations must be supported through its real property assets, as efficiently and cost-effectively as possible. Second, revenue from those assets not necessary to the primary transportation mission should be maximized and should generate fair market value to the MBTA. If possible, assets should both generate revenue and support the primary mission of the MBTA, i.e., through providing amenities to the ridership such as parking or retail, or through combining revenue-producing transactions with provision of services to the MBTA.

TRA's role as asset manager for the MBTA includes identification of the assets to be managed, analysis of the market context and MBTA operating context within which those assets may be categorized and evaluated; invoicing and collection of rents and fees; control, maintenance, and management of the records and documents (title and lease/license data) related to the assets; and implementation of a strategic program for marketing, leasing, developing and selling properties.

In order to fulfill the base asset management services with high professional standards, TRA needed to establish consistent filing systems, review all lease files, verify the accuracy of the billing and tenant administration systems, and review, negotiate, and execute new (or terminate) leases for the more than 800 agreements listed in the tenant billing system. These activities are arduous, and, since they are not expected to produce significant new income to the MBTA, are considered a management service. In addition, because the MBTA is a complex operations-oriented client, the asset management services include consistent coordination and cooperation with affected operating departments.

While traditional asset management would focus on leasing, development, and/or disposition activities, the MBTA contract also contains a significant licensing component. The MBTA issues licenses and permits to third parties to allow entry onto the authority's property to perform surveys, conduct environmental investigations, conduct repairs to their own facilities, or use the property for a short period. These licensing activities are viewed primarily as a service, since they are not expected to generate much cash flow; rather, they are intended to preserve the safety and integrity of MBTA facilities and key transportation activities.

TRA has over the past year initiated contact and issued questionnaires to 675 tenants-at-will; reviewed and ensured implementation of escalation clauses in about 125 existing agreements; engaged in activities that resulted in the collection of $1.4 million (88 percent) of outstanding rents due as of the date contract activities commenced; established monthly accounts receivable meetings to ensure that collection issues are identified and resolved; and corrected the tenant database to account for name changes and other lease terms. It has begun a systematic process of verifying and removing those agreements that have been terminated but were never removed from the tenant billing system; located more than 50 of the 80+ lease documents missing from the authority's lease files; and established lease policies and protocols so that tenants and the documents governing their tenancies are properly managed during the term of the contract.

As shown in table 1, Transit Realty's leasing and asset management services during the first year of the contract resulted in a 50 percent increase in overall rent receipts. TRA and MBTA collected $5.7 million in rents during FY97, a $1.9 million increase over the $3.8 million collected during FY1996. The dramatic increase in rental collections can be attributed in large measure to $1.4 million collected against amounts due prior to July 1996. However, TRA

[8] M.A. Soens & R.K. Brown, *Real Estate Asset Management: Executive Strategies for Profit Making 5* (John Wiley & Sons, Inc., 1994).

collected $3,972,000 from FY97 invoices of $4,674,000—an 85 percent collection rate for FY97 and a 5 percent increase over total FY96 rental receipts before collection of arrearages.

TRA has projected total rental receipts during FY98 to increase to $6.1 million, including approximately $5.1 million in rents from existing tenants, and an additional $1 million from new leases.[9] These projections reflect a 50 to 60 percent increase over the results achieved in earlier years. While this increase is significant, TRA has tied the rental figures to actual tenant agreements and/or specific assumptions regarding rental goals, so that any discrepancy between actual receipts and budgeted figures can be identified and, if necessary, explained.

[9] Some adjustments to these figures may be required, as TRA continues to evaluate and correct the lease terms in the tenant ledger and to assess whether the key assumptions of the budget are realized. The FY98 budget assumes that key approvals and decisions will be received by the MBTA in a timely fashion, and that both parties are motivated and able to close transactions within certain time constraints. For example, significant revenues were programmed from a revenue enhancement program that did not receive all necessary approvals within the projected time frame; therefore, the revenue projections for this program have been deferred for several months. For budgeting purposes, TRA has suggested a 5 percent allowance ($310,000) against total projected revenues, to account for vacancies, uncollectable rents, and delays in revenue realization. The FY98 rental budget is therefore $5.8 million.

Table 1. Asset Management: Key First-Year Results

Rent Invoicing & Collections	⇒	Issued invoices by the 1st of each month.
	⇒	FY97 rental receipts of $5.7M exceeded FY96 results by $1.9M, or 50 percent (including collection of arrearages in the amount of $1.4M).[a]
	⇒	Collected $1.4M in accounts for which rent was due prior to July 1996, reducing accounts receivable from period prior to TRA management by 88 percent.
	⇒	Collected $4.0M (85 percent) of the $4.7M invoiced by TRA during FY97.
Revenue Enhancement	⇒	Developed and began implementation of telecommunications master license program. Currently negotiating or bidding agreements valued at more than $1M/year.
	⇒	Identified $6.0M + Lease Program for FY98.
Systems Development	⇒	Established lease management and tenant management systems, including procedures for collection of outstanding rents and fees.

[a] Total receipts of $5.7M include approximately $343,000 received by the MBTA prior to July 22, 1996, $3,972,000 billed and collected by TRA during FY97, and $1,389,000 in collection of rents and fees due prior to July 1996 (i.e., accounts receivable).

Special Projects

During the first year, the team also looked for areas in which the combination of TRA principals' entrepreneurial experience, combined with the experience of former MBTA staff (now TRA employees), could add value. In addition to the telecommunications program, one such opportunity arose in the retail and pushcart programs. The bidding process is quite cumbersome and inhibits the landlord's ability to negotiate improvements in exchange for rent provisions, or even to identify standards for build-out. Jack Neuwirth, a former MBTA project manager, and TRA Project Manager for retail development, had been working for over a year to find a way to expand an existing retail location at Harvard Square Station in Cambridge. TRA engaged an architect to develop a vision and build-out standards for the space based on Mr. Neuwirth's input, and TRA approached the MBTA for feedback. In a meeting attended by multiple departments, TRA and MBTA staff worked out a plan that could accomplish the higher level of build-out sought, while accommodating both design sensitivities and operating concerns at this station.

By taking the initiative and the financial risk up front at Harvard Square Station, TRA was able to help accomplish two important goals: adding value to the MBTA through improvements to their station and enhancing the ridership experience. Because the retail market within MBTA stations is so difficult to predict, the revenue component of this lease won't be known until the bids are in.

The systemwide pushcart program is another innovative MBTA program, which TRA is helping to expand. The pushcart program allows a single operator to manage a series of vendors throughout the MBTA transit and commuter rail system, through short-term licenses. The operator builds and leases pushcarts to entrepreneurs, who are able to conduct small retail businesses within MBTA stations with nominal start-up costs.

The pushcart program is a fluid and dynamic program designed to enhance the variety of customer services provided by a limited number of fixed retail concessions. The program generates about $100,000/year for the MBTA while offering opportunities to small businesses who have little access to capital resources. Over the past year, the pushcart operator issued more than 40 new licenses to 26 vendors. But the total number of licenses within the system (44 licenses as of July 1997) increased by only seven: these figures reflect the high level of turnover in the program. Indeed, figures indicate a 90 percent turnover in pushcart operator and location. Of the 44 active pushcart licenses, only four were with vendors who were in the same location last year—the remaining 40 were either new vendors or new locations throughout the transportation network. TRA is working closely with the push-cart operator to expand the program into new areas of the MBTA's system and to upgrade the standards of operation.

Real Estate Inventory

The real estate inventory is a key element of the MBTA/TRA contract, since it will 1) enable the MBTA to identify and evaluate what it owns, 2) vastly enhance the ability of asset managers to evaluate the status and value of geographic portfolios, and 3) create efficiencies for multiple MBTA departments. The task of creating the real estate inventory includes identification of the MBTA's real estate ownership (or leasehold) interests throughout the Commonwealth, as well as identification of encumbrances to those interests, such as easements, leases, licenses, and the like.

As this work continues, TRA is coordinating with MBTA staff to begin to identify their information needs as they relate to real estate. For example, the MBTA Police have an urgent need to understand which properties are owned or controlled by the MBTA so that they may appropriately respond to emergency calls; the MBTA planning department needs to understand the property interests of the MBTA so that they can plan for new facilities or transportation routes and identify the costs associated with their planning recommendations; and the MBTA design and construction department needs to understand the limits of MBTA property ownership as it designs and constructs new facilities.

Finally, TRA must identify and recommend a strategy for developing an inventory system to manage the real estate data, and upon approval by the MBTA, implement the software development strategy. The real estate inventory system (REIS) is currently conceived as a geographic information system, with the capability of linking geographic information with critical data elements related to the property. The goal is to create an integrated system with which to provide a platform for sharing information. Ultimately, MBTA staff in multiple departments would have access to the same data.

In its first year of operations, TRA has developed a computerized database for storing information relating to MBTA properties. The database includes information relating to location, size, acquisition, deed (i.e., book and page), city assessor's data, environmental information, zoning, maps and plans, encumbrances, and relevant contact persons. The system has the capability of linking to other databases (e.g., a lease database and work process databases).

TRA staff have entered and cross-referenced 1,700 of the 2,200 parcels for which ownership information was made available by the MBTA and estimates that all 2,200 parcels will have been entered by the end of September 1997. This means that, for every parcel for which information is available, the parcel's identification number, location, size, title information, assessed value, valuation plan number, rail line and station, use, and zoning have been cross-referenced and entered.

Table 2. Real Estate Inventory: Key First-Year Results

Database Development	⇒	Developed computerized inventory system.
	⇒	Linked database to TRA Project Database.
Identification of MBTA Property	⇒	Entered data and cross-referenced 1,700 of 2,200 known parcels.
	⇒	Identified strategy to verify title and other data.
Coordination with MBTA	⇒	Interviewed key MBTA departments to identify database needs and data sources.
Real Estate Inventory System (REIS)	⇒	Developed preliminary REIS strategy and budget.

As a result, TRA is able to answer and provide documentation for inquiries regarding property ownership in a matter of minutes or hours, rather than the days or weeks that would otherwise be required.

A few months ago, a Massachusetts Senator requested a listing of every MBTA property located within her district: and she wanted it *immediately*. TRA was able to supply this information within 24 hours of receiving the request from the MBTA.

The database leads not only to internal efficiencies, but also enables TRA to assist the MBTA in key functions. For example, the MBTA law department must routinely handle accident cases on or near MBTA facilities. The key to potential MBTA liability, however, is whether the accident occurred *on* or *near* the facility. Having this information readily available can save thousands of dollars in staff and/or outside counsel costs in each case. In addition, the MBTA routinely receives requests from a variety of interested parties for information pertaining to MBTA property. Such efficiencies may not lead to additional revenue, but they do allow MBTA staff to perform their functions without the frustrating, day-to-day hurdles caused by lack of information.

While TRA has made significant progress during its first year of operations, development of the REIS still has a long way to go:

Existing property information must be verified, and a search must be conducted in each registry to determine which property interests have been acquired and/or sold by the MBTA over the past 20 or more years. The MBTA has estimated that it may own up to 4,000 parcels, almost twice the number for which information is currently available. That information must be collected in a coherent fashion and entered into the database.

The database must be developed and linked to a graphic base through existing digital information, where available, or through newly created information. This means, potentially, surveying on a prioritized basis significant parcels of land throughout the Commonwealth.

Hardware and software need to be acquired and developed to serve the MBTA's needs, in a manner that recognizes the ever-changing world of technology and ensures future compatibility with emerging technology.

The REIS should be linked with existing and future MBTA databases, so that real estate information becomes fully integrated with affected department functions.

TRA anticipates that this program will require a concentrated and sustained effort over the next four years, but that it will result in the creation of meaningful revenue-enhancing and cost-saving efficiencies for both TRA and the MBTA.

Surplus Property Disposition

TRA is responsible for the sale, lease, and/or development of properties that are surplus to the authority's needs. For example, air rights can be granted over urban parcels, disused or underutilized portions of actively used transportation facilities may be sold or leased, and property acquired through a prior transportation expansion program may be found to be surplus to the current and programmed operating needs of the authority and may therefore be offered for sale. The authority also routinely grants easements for utilities and other uses.

During the first year of operations, TRA was required to review certain of the authority's properties for their sale and/or development potential, to recommend a disposition program to the authority, and to prepare a marketing/disposition strategy for those properties. TRA has recommended a $4.1M disposition program for FY98. This program, if achieved, would more than double each of the three prior years' sales revenues.

While FY97 sales results were lower than anticipated—$600,000 in sale revenue versus $1.6M during FY96—these results were largely due to the process and time frame required to close a sale of MBTA property (at a minimum, the process requires 6 months to 1 year), delays relating to identification of the property interests to be conveyed and other closing issues, and the types of sale transactions completed.

Table 3. Surplus Property Disposition: Key First-Year Results

Sales and Disposition Program Development	⇒ Collected $600,000 in sales revenue. ⇒ Identified $4.1M+ sales/disposition program for FY98.
Disposition Procedures	⇒ Recommended changes to disposition procedures to streamline process and enhance value to MBTA.

This year's lackluster revenues are also due in part to intervention by TRA in several instances to stop a transaction. In one case, the MBTA was close to granting an apparently inconsequential access easement at a major urban transportation hub to an abutter and asked TRA to come into the deal to help negotiate the final details of the transaction. TRA discovered that, not only would the access easement have benefited the abutter by more than 10 times the proposed purchase price, the overall transaction would have meant a loss in development potential to the MBTA of $10 to $15 million.

In order to ensure the success of the FY98 program, TRA has reallocated internal resources to create a disposition team. The FY98 disposition program identifies specific parcels for disposition and, like the lease revenue program, will allow for direct accountability—systems are in place to measure assumptions and projections against actual results, and the contractor will be prepared to explain any discrepancies.

It is important to note that, while the TRA disposition program identifies 20 to 25 properties for disposition, TRA received approximately 100 requests during the past 12 months from parties seeking to purchase MBTA property. Because TRA, as the "designated MBTA representative," is required to respond to each and every request, the company cannot focus all resources on achieving the projected revenue results. Unlike a representative of a private sector landowner, TRA must respond to requests that are unlikely to result in a transaction, or may well result in a transaction that generates less revenue than the transaction cost. Therefore, even the disposition program has a significant service component.

In early 1997, TRA made a series of recommendations for administrative and legislative changes to allow for more efficient land disposition procedures. Recognizing that the public bidding statutes are based on sound policy concerns, TRA has recommended that these statutes be revisited to allow the public sector more flexibility in conducting real estate transactions. The key elements underlying these statutes—accountability and respect for public resources and the public trust—must be preserved but, because the bidding laws can actually work against enhancing value to the public, other mechanisms to provide these assurances should be considered.

As we move forward, TRA continues to identify and evaluate properties for their disposition potential and regularly reviews and evaluates third party requests to acquire MBTA property. TRA and MBTA anticipate that the demand for property will remain strong during the next few years, allowing the authority to realize significant revenue gains.

Joint Development

During the first six months of the contract, the MBTA asked that TRA provide a study of several potential joint development sites, prioritize sites for development, provide a schedule for developing those sites, and define a process for developer selection. This report is intended to serve as the basis for the MBTA's joint development program. Upon review of the recommendations set forth in the study, TRA will prepare and issue Requests for Proposals and manage the developer selection process. Finally, TRA will negotiate joint development agreements with selected developers and will oversee all aspects of the development—from construction to management of the development agreements over time.

Table 4. Joint Development: Key First-Year Results

Joint Development Report	⇒	Evaluated 15 potential sites and identified five high-priority development sites.
Linked to Parking Garage Program	⇒	Linked three high-priority sites to the parking garage program to enable the MBTA to leverage private investment in order to finance garage program.
Positioned Projects for Development Pipeline	⇒	Prepared first RFP for Fall 1997 issuance.
	⇒	Began marketing MBTA properties.

	⇒ Evaluated other proposed developments in anticipation of negotiation or RFP preparation.

Efforts by TRA principals and staff to identify, market, and achieve development deals at joint development sites are not likely to show financial results for another 12 to 18 months. But these efforts, which are quite significant, have resulted in a substantial and viable program for development of MBTA properties, as well as a market that is actively interested in bidding on selected properties. As of October 1997, the first RFP had been issued and proposals received.

Parking Garage Program

An important goal of the TRA/MBTA contract is the development of up to 5,000 new parking spaces within new garages, to satisfy both the transit-oriented parking demand and the authority's Central Artery mitigation commitments. The garage program would provide the maximum number of parking spaces to the authority at critical locations, with the least impact on capital and operating funds. The contract set a goal of constructing garages with hard costs of less than $9,000 per space.

In the initial phase of the program, TRA prepared a "Garage Feasibility Study," which evaluated 1) market and physical characteristics of several sites; 2) community and environmental concerns and impacts; 3) financial structures, including parking rate analysis and suitability for other related development; 4) accessibility and potential traffic impacts; 5) permitting requirements; 6) nature and costs of necessary site improvements; and 7) soil conditions. These sites were then ranked according to their suitability and ease of development, and an overall program to construct up to 5,000 additional parking spaces was recommended to the MBTA.

Table 5. Parking Garage Program: Key First-Year Results

Feasibility Study	⇒	Prepared parking garage feasibility study evaluating potential of 23 MBTA sites.
	⇒	Identified six high-priority garage sites.
	⇒	Recommended program that would
	∞	leverage $100+ million in private investment in 3 communities served by the MBTA
	∞	develop a total of 7,200+/- structured parking spaces (including 3,200+/- additional parking spaces) in six communities, providing urgently needed parking at major MBTA stations
	∞	accomplish the construction of more than 3,000 new parking spaces toward the MBTA's Central Artery mitigation commitment
	∞	enable the MBTA's transportation operations to perform more smoothly and provide better service to the authority's ridership
	∞	provide both construction jobs and ongoing (post-construction) economic activity
	∞	provide a revenue gain to the authority of more than $50 million in net cash flow after debt service, over the term of financing (approximately 30 years).

Once the method of financing the parking garage program is approved by the MBTA, TRA will proceed with design and permitting activities, followed by construction and, finally, management of the garages.

At the time of this writing, TRA and the MBTA real estate department have prepared a recommendation for MBTA Board approval of a significant parking garage/joint development opportunity for the MBTA.

As part of TRA's mandate under the Services Agreement, the company evaluated 23 parking garage sites and 15 joint development sites proposed by the MBTA. These sites were first evaluated independently for their potential as parking garage sites or joint development sites. Following more extensive site evaluation, financial analysis, and market feasibility, the sites were tested for their potential as both parking garage and commercial development parcels under long-term lease or sale scenarios.

TRA's joint development analysis identified five of the initial 15 sites as high-priority joint development sites. These MBTA properties were subjected to a ranking system and were selected as high-priority sites because the site characteristics and identified market interest indicated immediate development potential. Similarly, TRA's parking garage feasibility study identified six high-priority parking garage development sites. These sites were selected on the basis of a) the present and projected need for additional parking at the location; b) the capacity of the site to accommodate projected parking demand; c) cost-effectiveness of the parking garage design, construction, and management; d) the likelihood that extraordinary site costs or permitting requirements could be avoided; e) the potential for additional development at the site; and f) the likelihood of community support for the project.

Following extensive review, six sites stood out as prime locations for structured parking, three of which offered immediate development potential. Implementation of the proposed parking program will result in an increase of MBTA parking capacity by approximately 3,200 parking spaces at an average total cost of less than $8,000 per space; positive net cash flow to the MBTA after debt service, beginning in Year 1; and generation of more than $50 million in net cash flow to the MBTA after debt service over the term of financing.

The proposed program assumes that the MBTA and other relevant governmental entities will commit to spending approximately $10 million in federal funds for the construction of two of the recommended garages. These federal funds have previously been earmarked for the garages, but have not yet been spent because required matching funds have not been available. The proposed financing of the garage/joint development program described above would relieve the MBTA of the obligation to provide matching funds; instead, these funds would be provided through private financing. Thus, rather than burdening the government with the total cost of garage construction, operation, and maintenance, the proposed garage development will be financed in three parts: 1) $10+/- million in federal funds as described above; 2) $13+ million in revenues derived from the sale of development rights at three of the proposed sites; and 3) net private financing of approximately $35 million.

This program will allow the authority to proceed with the implementation of a major development and parking garage construction program that captures current real estate market demand, creates transit-oriented development with major economic benefits for communities served by the authority, takes advantage of the opportunity to construct more than 3,000 parking spaces with no impact to MBTA cost of debt service or operating funds, and generates additional revenues to help support MBTA operations and reduce net cost of service.

MBTA and TRA are also evaluating an alternative approach in which TRA would design and build the garages, with the MBTA providing financing from its own budget. Under this scenario, the MBTA would also manage the garages in the traditional manner after the first five years of operation.

Monitoring by MBTA

The MBTA/TRA contract provides several mechanisms by which the MBTA can monitor contract performance and control the management and disposition activities contemplated by the agreement: 1) TRA may not execute any document on behalf of the MBTA until approvals have been received by relevant MBTA departments. 2) Any disposition for a period of greater than five years must currently be approved by the MBTA Board of Directors. 3) Any permanent disposition of MBTA property must be approved by the MBTA Board of Directors, as well as, in some cases, the Secretary of Transportation. 4) TRA is obligated to provide monthly reports describing all its activities under the contract, from receipt of revenue to the types of phone calls logged. Finally, all of TRA's transactional activities are subject to statutory bidding constraints.

Costs and Benefits

The benefits of outsourcing the MBTA's real estate functions have already become apparent. Transit Realty has established the key elements of a professional asset management program: rents are being billed and collected; concentrated and sustained efforts to reduce accounts receivable are showing demonstrable results; filing systems have been established and are being maintained; the tenant database is being corrected and updated, so that it will provide accurate and current information; budget and revenue tracking systems have been produced to ensure accountability going forward; documentation of tenancies is ongoing; and new programs to enhance revenues have been identified and implemented.

TRA has spent a good portion of its first year establishing document management systems and other procedures that will provide the foundations for performance enhancement over time. These higher management standards will result in greater efficiencies and accountability to the MBTA and its constituents. The real estate inventory, as well, adds significant value to the MBTA, merely through documenting, tracking, and managing property information by current industry standards. By the end of the five-year contract, through implementation of the REIS strategy, the MBTA should have a state-of-the-art geographic information system that can be accessed and used—on a daily basis—by multiple MBTA departments.

The proposed parking garage/joint development Program will also achieve a number of the MBTA's central goals, including revenue enhancement, cost avoidance, and provision of key services to the ridership.

Finally, TRA has recommended changes to the way business is currently done—which are both administratively and legislatively driven—to allow for streamlined processes, better provision of services, and realization of better results for the MBTA and its constituents.

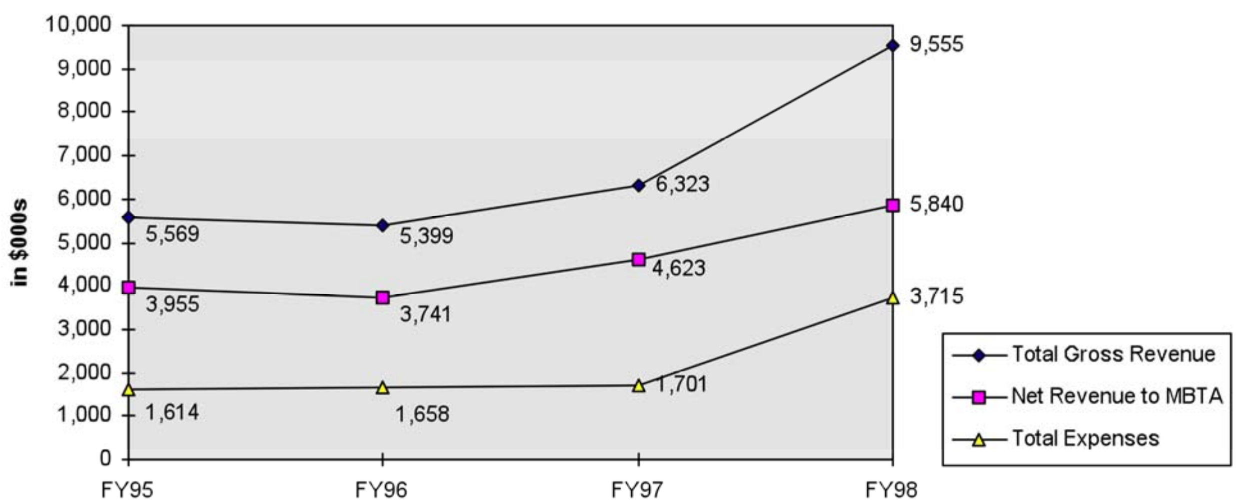
Table 6. MBTA and TRA: Actual and Projected Real Estate Net Revenue, FY95-FY98

	MBTA Actual Revenue & Expense, FY95	**MBTA Actual Revenue & Expense, FY96**	**TRA Actual Revenue & Expense, FY97**	**TRA Projected Revenue & Expense, FY98**
Revenue Sources - Lease Income				
Total Existing Rent	$3,983,826	$3,796,046	$5,697,285	$4,931,772
Increase for Adjustment to Tenants at Will				$138,372
New Tenant Rents				$1,033,643
Subtotal - Leases	$3,983,826	$3,796,046	$5,697,285	$6,103,787
Other Real Estate Revenue				
Sales, Fees, etc.	$1,585,281	$1,602,912	$626,089	$4,167,002
TOTAL GROSS REVENUE	$5,569,107	$5,398,958	$6,323,374	$10,270,789
Allowances to Gross Revenue				($715,390)
TOTAL ADJUSTED GROSS REVENUE	**$5,569,107**	**$5,398,958**	**$6,323,374**	**$9,555,399**
Expenses				
MBTA Real Estate Department	$1,220,729	$1,257,351	$250,000	$257,500
Indirect & Other MBTA	$228,604	$235,674	$268,409	$279,006
TRA Base Management			$1,143,000	$1,203,000
TRA Fees & Commissions			$11,398	$573,199
Third Party & Other	$165,000	$165,000	$27,963	$1,402,500
TOTAL EXPENSE	**$1,614,333**	**$1,658,025**	**$1,700,770**	**$3,715,205**
NET REVENUE TO MBTA	**$3,954,774**	**$3,740,933**	**$4,622,604**	**$5,840,194**

Notes

1. FY97 rental revenues of $5,697,000 include $1,389,000 in receipts from invoices outstanding as of July 1996 and $343,338 in rental receipts collected by the MBTA during July 1996.
2. FY98 rental revenue projections of $6,103,787 include approximately $1,033,643 in new lease revenues; FY97 new lease revenues have not been separately calculated.
3. FY97 and FY98 revenue shown for Sales, Fees, etc. is net brokerage fees (including TRA brokerage fees on property sales).
4. MBTA Real Estate Department expenses are derived from the MBTA's 1995 submittal to the State Auditor and reflect actual MBTA expenses for staff, rent, supplies, etc.
5. Indirect and other MBTA expenses are derived from the MBTA's 1996 submittal to the State Auditor and are conservatively estimated to continue at FY95/96 levels throughout the term of the TRA agreement.
6. Third Party & Other expenses include legal, appraisal, title, survey, and other transaction-related expenses, as well as costs related to the completion of the first phase of the property inventory.
7. The FY98 Allowance to Gross Revenue is an allowance for 1) uncollected rents, 2) failure to close transactions due to inherent uncertainties in the approval and bidding process, and 3) other factors beyond the control of TRA.

Chart 1. Actual and Projected Net Real Estate Revenue



Note: FY98 figures are projected.

Costs and Revenues

In its submission to the State Auditor's Office, the MBTA estimated that, for all the services contracted to TRA, the Commonwealth would gain between $5 million and $7.5 million in combined cost savings and enhanced revenue over the five-year term of the contract. TRA's first-year results, revenue projections, and currently recommended programs support those figures.

The MBTA estimated its pre-contract in-house costs to support the real estate function to be approximately $1.5 million per year, or about $7.5 million over 5 years.[10] Because the MBTA retained three staff to manage the contract and provide in-house coordination, post-contract costs are estimated to be about $250,000/year, resulting in avoided costs of about $1.25 million/year. These avoided in-house costs approximate the costs incurred by the MBTA for the base management fee earned by the contractor. However, the contractor is required to provide a higher level of services than previously

[10] The costs referenced here reflect MBTA costs allocated to the real estate department, as well as a portion of previously incurred rent, utilities, and materials. These costs do not include transaction-related expenses, which are accounted for in the net operating income figures provided, nor do they include indirect costs, which, for purposes of this paper, are conservatively estimated to remain about the same from FY1995 to FY2001. These figures and the assumptions that support them are derived from those provided in the MBTA's formal submittal to the Office of the State Auditor (which the authors understand were the subject of substantial debate between the Office of the State Auditor and the MBTA).

achieved by the MBTA real estate department. In addition, the contractor is highly motivated to improve revenues to the MBTA, since additional income is tied to MBTA revenue.

Through the fee structure, the MBTA has capped its expenses, tying additional fees to performance standards, sales and leasing, garage design, construction and management, and joint development activities. For example, TRA is entitled to a brokerage fee for the sale of property, but only after the transaction closes. Similarly, lease brokerage fees only bring value to TRA when the lease is signed and the tenant pays the first month's rent.

TRA is also motivated to be as efficient as possible. TRA has invested more than $75,000 in computer equipment, software, and software development, including a series of automated systems for tracking projects, generating reports, and linking the authority's ownership information with existing leases, projects in the pipeline, and future parking and/or joint development projects. TRA expects to invest additional funds in equipment acquisition and technology development through the end of 1997.

Fiscal Year 1997 results show gross revenues of almost $1 million more than each of the previous two fiscal years. The FY98 program projects gross revenues of about $3 million greater than FY97 revenues. The collection of $1.4 million in aged accounts receivable (while maintaining the level of annual rents collected in previous years) is an early indication of added value. Net revenue to the MBTA during FY97 was $4.6 million, representing an increase of more than $850,000 over FY96 net income results.

While the sales program fell short of expectations in FY97, the program is poised for success in FY98. Achievement of FY98 revenue projections of $9.5 to $10 million—almost double the average revenues achieved in previous years by the MBTA—will say much about the financial success of the outsourcing. This revenue projection does not include any revenue from the joint development or parking programs, since those revenues are not likely to be realized until fiscal years 1999-2002. The FY98 program projects total *net* operating income, including all TRA fees, transaction costs, third party expenses, and several hundred thousand dollars for property inventory development, of nearly $5.8 million—$500,000 more than the authority's FY96 *gross* revenue from real estate activities.

Current revenue and expense projections would yield a $2 million increase in net revenue to the MBTA during the second year, for a total additional net revenue of $2.85 million over the first two years of the contract, *including* the costs to develop the first phase of the property inventory.

Continued Measurement of Costs and Benefits

Costs and benefits can be measured in several ways going forward. First, the revenue and expenses (net revenue) to the MBTA can be measured against expenses and net revenue prior to commencement of the TRA Services Agreement for similar levels of transaction activity.

Second, additional services provided by TRA, and the measures of accountability, including reporting requirements and other elements of contract compliance, contribute to higher standards for the services provided under the agreement.

Third, cost savings can be measured when a transaction incorporates value to the MBTA although the value is not directly reflected by revenue. This would be the case, for example, if a lease requires a tenant to perform work that would normally be the landlord's responsibility, or if a sale transaction provides for indemnification of the MBTA for the environmental condition of a site, thereby allowing the authority to avoid a short-term or long-term environmental liability. The parking garage program is fundamentally a cost avoidance measure, allowing the MBTA to realize many elements of value within one program.

Finally, cost avoidance can be measured by reviewing internal efficiencies and cost savings realized through TRA's activities. These can be difficult to measure, especially if they relate to time-saving measures or the ability to avoid engaging a consultant or contractor to perform a task. But one example of how certain costs can be avoided relates to the property inventory, which will generate very significant cost savings through avoided legal and survey consultant work, avoided costs in identifying areas of actual or potential liability, and overall efficiencies created through shared information.

Obstacles

In order to outsource a significant department within a public agency, forces must be in place to overcome obstacles that arise:

Misinformation. Much misinformation will surface that needs to be corrected as soon as possible. Managing perceptions and squelching false rumors are critical throughout the outsourcing process. At the outset, the MBTA considered engaging a marketing firm to help shape perceptions and offset the spread of misinformation. This did not occur, and some regret was expressed later on.

Inadequate database and support systems. Solid information is fundamental to transfer and assumption of management functions. Even with the national accounting firm's lease review, many unforeseen problems surfaced after the transfer. For example, the lease management software selected by the MBTA required additional fields and upgrading to handle the volume of leases and data points, and neither the amount nor the accuracy of data provided were at the level anticipated. TRA invested hundreds of hours of staff time reviewing documents and upgrading the database and support systems. The company needed more than double the amount of filing space it planned for (and floor area to accommodate it).

Transition Time. A period of time must transpire to allow for decision makers, such as the Board of Directors, to gain a certain comfort level with the new management and its way of doing business. Some time will be lost and transactions deferred during this transition period, which will have an impact on the results-oriented approach the contract is intended to create.

Organized Labor. "Privatization" is often perceived as a threat to organized labor, which may be expected to garner its resources to resist such an initiative. Under provisions of the Commonwealth's privatization act, known as the Pacheco Law (described below), labor has the right to put together its own bid to perform outsourced functions. Labor has a strong presence in the MBTA. The real estate department had 6 union employees out of 26, including one manager. While union representatives submitted a proposal to assume the outsourced functions, the proposal was deemed unresponsive, as being at a higher cost than current departmental costs.

Gaining State Approval of the Outsourcing Initiative. As provided for in MGL c.7 §§ 52-55 (the Pacheco Law), the sponsoring agency must submit a document to the State Auditor's Office that shows a cost savings to the Commonwealth for any outsourcing initiative. The following are among other requirements of the submission:

- Certification that the state Director of Finance and Administration and the General Manager of the MBTA approve of the report and its findings.
- A statement of services to be rendered.
- The contract for services to be rendered.
- Comparison of the costs of the existing functions and the proposed functions and the assumptions regarding accrued savings.
- Summary of the bids received for the contract services.
- Specification of the bid criteria and rating system for the award of the service.
- Documentation of the proposed bidder.
- A management study addressing the efficiencies that have been attempted and/or could be realized absent this privatization effort.

The Auditor's Office has exercised wide discretion in requesting supporting documents and asking for additional information. The Auditor has 30 days to object or the contract is deemed approved. In the case of the real estate submission, the Auditor's Office disagreed with the amount of savings indicated, but because the Auditor did find some savings, the contract was "not objected to" and the outsourcing initiative proceeded.

The types of assessments and submittals required under the Pacheco Law are often problematic, expensive, and time-consuming for a state agency. To demonstrate expected cost savings, the agency must compare the outsourcing proposal to a hypothetical scenario in which its own staff perform the services "in the most cost-efficient manner," a situation that has never existed and is unlikely to in the future.

Assessment for Replication

The outsourcing of real estate functions could be replicated within other agencies and authorities of the Commonwealth and throughout the country. Few transit authorities and other public agencies give real estate a primary focus within their organization. Without this focus, the allocation of human and technological resources to support it, and the ability to first prepare for and then respond aggressively and creatively to market conditions, the public sector cannot realize the highest potential of perhaps its greatest "hidden asset"—its land and facilities.

Delegation of real estate functions to private parties who are motivated to perform through both contractual obligation and profit incentive allows public sector landowners to realize the benefits of professional expertise at a reasonable cost. Based on these factors, outsourcing of real estate functions within other agencies not only could be replicated, but, in many cases where the public sector landowner has significant real estate holdings, should be replicated.

In order for outsourcing to succeed, the affected agency must

∞ Identify a need for change. In the case of the real estate department, the lack of follow-through on the 1993 organizational diagnostic and the overriding need to reduce the state transit operating deficit were the real motivations behind this initiative.

∞ Ensure high level support. Senior management needs to be clear in its direction to the organization to overcome inertia and institutional resistance that naturally occurs with any significant change in structure and personnel. Key policy decisions must be made in concert with the highest levels of management. A schedule of milestones for the MBTA real estate outsourcing was established at the outset, provided to the affected parties, and monitored closely.

∞ Effect adequate delegation of discretion. There is a delicate balance between giving the contractor discretion sufficient to execute programs and losing control of transactions that may affect public policy issues. In this case, the contract spelled out tasks the MBTA was required to perform, but in some cases the internal resources and support required within the MBTA has failed to materialize in a timely manner. Also, the MBTA's Director of Real Estate sought clarification of his decision-making responsibilities under the new contract and did not always receive it. As the function became more comfortable to him and high-level support for his decision-making materialized, he was able to step out of traditional agency roles and assume more risk and responsibility.

∞ Provide appropriate support from the agency's operating staff. The success of such a transfer in authority and function requires daily support and interface with the operating divisions. In this case revenue-producing real estate activities must be coordinated to ensure they do not interfere with the primary transportation function. TRA fully recognizes that the real estate function must be subordinate to the operations functions of the MBTA and is actively seeking a more integrated relationship with the commuter rail, transit operations, bus operations, planning, and design/construction units, so that the contract team may act quickly but responsibly within the transportation context to enhance revenues, services, and amenities to the ridership.

∞ Offer clear gains for both the agency and the contractor. The parking garage construction program was initially conceived as providing the carrot to the contractor to bid on the RFP, while (hopefully) finding a creative way to finance the spaces, should public financing be constrained. If the parking program is successful, the MBTA will realize the benefit of providing more than 3,000 new parking spaces at no net cost to the authority, and TRA will receive the anticipated upside of this incentive. And, given that most if not all public funding sources evaporated between the time of contract approval and the date of contract commencement (a period of about three months), this approach to contracting for construction of these parking garages will be an enormous benefit to the authority.

∞ Ensure that the agreement requires accountability from both parties.

Looking Ahead

The past year of creating this private/public partnership has often been difficult. Both the MBTA and TRA have had to learn to work together to achieve a successful real estate program, while bridging vast gaps in expectations. While TRA predicts an even more successful program going forward, much needs to be done to ensure that our mutual expectations—

contractual and otherwise—are first understood and then met.

About the Authors

Patrick Moynihan is Secretary of Transportation and Construction for the Commonwealth of Massachusetts and chairman of the MBTA Board of Directors.

Richard Flier is a principal of Transit Realty Associates, LLC, the joint venture under contract to manage the MBTA's real estate interests. He is a principal in several other companies, including Farmer & Flier, which focuses on real estate investment, development, consulting, and brokerage.

Clare Conley is chief operating officer for Transit Realty Associates and a former manager of leasing and asset management for the Massachusetts Port Authority.

Lisa McCallum serves as deputy chief of staff at the MBTA and was formerly special assistant to Indianapolis mayor Stephen Goldsmith.