

LITTLE HOOVER COMMISSION

SQUEEZING REVENUES OUT OF EXISTING STATE ASSETS

June 1992



Little Hoover Commission

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June 23, 1992

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Jeannine L. English
Executive Director

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Governor of California

The Honorable David Roberti
President Pro Tempore of the Senate
and Members of the Senate

The Honorable Willie L. Brown Jr.
Speaker of the Assembly
and Members of the Assembly

The Honorable Kenneth L. Maddy
Senate Minority Floor Leader

The Honorable Bill Jones
Assembly Minority Floor Leader

Dear Governor and Members of the Legislature:

Over the last few months as the budget crisis loomed ever larger, we have tried to identify ways in which the State can generate funds in the short-term in response to our predicament. After reviewing the area of real property management, we believe that an immediate modification of certain policies holds the key to perhaps as much as \$115 million in additional revenue for the coming fiscal year.

To assist the Legislature in their deliberations, attached is a brief issue paper prepared by Commission staff. The paper gives a history of property management practices, appraises the current status of state policies and outlines the recommendations that, if implemented immediately, could ease the adverse impact of California's financial emergency. In general, the recommendations call for giving (for a limited time) the Department of General Services the necessary authority to:

- * dispose of surplus state lands;
- * negotiate lease-purchase agreements; and
- * negotiate long-term leases.

In fact, the Department of General Services already has identified as under-used certain properties for which the State could pursue alternative uses. Based on previous studies, the State could earn millions of dollars from different uses of land without selling any assets.

To ensure that these new policies do result in more revenues for the State and to assist the Legislature in determining whether these policies should be made permanent, the Department

should be required to report semi-annually to the Little Hoover Commission on its progress in proactively managing property. The Commission, then, will independently evaluate the Department's progress and report to the Legislature.

I hope the information provided is helpful. If there are any questions, please don't hesitate to call the Commission's Executive Director, Jeannine L. English (916/445-2125).

Sincerely,

A handwritten signature in black ink, appearing to read "Nathan Shapell", written in a cursive style.

Nathan Shapell
Chairman

Little Hoover Commission Issue Paper

Squeezing Revenues Out of Existing State Assets

For the past seven years, the Little Hoover Commission has analyzed and suggested improvements in the system by which the State manages its real property. Reports issued by the Commission in 1986 and 1990 contained recommendations that, if implemented, could save or gain the State of California hundreds of millions of dollars. To date, a few steps have been taken toward the goals embodied in the reports, but the broad reforms suggested by the Commission have yet to be realized. Consequently, the State continues to forego significant, long-term financial potential.

The time has now come, however, for the State to heed the call to financial arms. Faced with an \$11 billion budget deficit, it can ill afford to ignore any plausible options to augment immediate savings and/or revenues.

This issue paper is designed to give the State's decision makers a brief history of what has transpired since the Commission released its most recent report on property management, an appraisal of the current status of property management and recommendations that can be immediately implemented to impact next year's budget and aid in resolving the current financial crisis.

Recent History of Property Management

In October 1990, the Commission released its report, "Real Property Management in California: Moving Beyond the Role of Caretaker." The report painted a picture of an inefficient and ineffective State asset management system and recommended sweeping changes in the way the State manages its real property. In general, the report found:

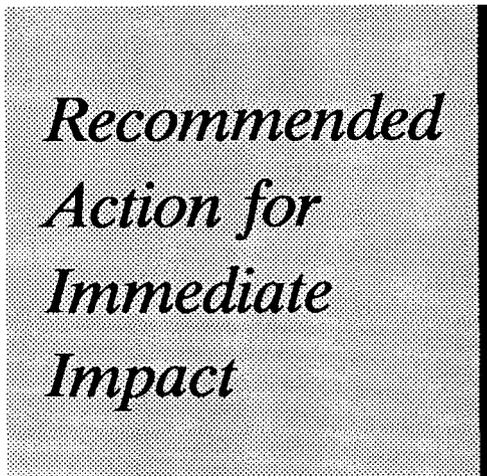
- * The State has an incomplete and inadequate structure for pursuing a proactive management strategy.
- * The State has a fragmented and incomplete approach to planning for its long-term needs.
- * The Statewide Property Inventory lacks crucial elements for it to be an effective property management tool.

- * Many of the State's current statutes, policies and procedures inhibit proactive management.

Among the Commission's recommendations was a suggestion that the State create a central administrative structure for the State's proactive real property management system. Only through a single, bipartisan entity can the State ensure implementation of policies focused on the optimum use of properties for the State's operations and maximum value from excess properties. Further, such an entity must allow the continuance of the checks and balances necessary to ensure that the Legislature and the Executive Branch are involved in the decision making process. To establish such an entity, the Commission recommended that the authority, mandate and composition of the current Public Works Board be significantly expanded. The Commission sees a revised Board as a viable entity in which to vest authority for managing the State's real property because of the Board's ability to ensure broad-based representation from all of the major interest groups, including the Legislature.

In sponsoring legislation (AB 324, Areias) to implement this recommendation, however, the Commission ran into extremely stiff opposition. Such resistance was anticipated from the myriad agencies individually responsible for managing property because of their reluctance to relinquish control of their "fiefdoms." What was not expected was the Administration's "about face" on their previously declared support for a consolidated approach to managing property. In opposing the legislation, the Administration raised a number of technical issues that it felt needed to be addressed, but offered no specific amendments or substantive assistance to make the changes necessary to shore up the bill's perceived shortcomings. In short, Commission staff interpreted the Administration's opposition as a willingness to continue to attempt "Band-Aid" approaches rather than true reform of the system.

Although the Commission still firmly believes that a revised Public Works Board is the appropriate entity to proactively manage the State's real property, staff also recognizes that, at least for the near future, substantive structural reform as recommended by the Commission is doomed to be bogged down in a political quagmire.



We therefore turn our attention to the current budget crisis and an immediate method of restructuring a portion of the property management system that would overcome some of the current barriers to the management of real property but would continue to provide the checks and balances that we think are necessary to achieve bipartisan oversight. In general, Commission staff recommends a modification of legislative involvement in some areas crucial to the success of proactive management. Specifically, we recommend that, for a period of three to five years, the Department of General Services be given the authority to engage in the following activities:

- 1) The disposal of surplus state lands;
- 2) The negotiation of lease-purchase agreements; and
- 3) The negotiation of long-term leases.

In addition, the department should be required to report semi-annually to the Joint Legislative Budget Committee and the Little Hoover Commission on its progress in using its new tools to manage property. The Commission, in turn, should independently evaluate the department's progress and report to the Legislature. At the end of the three- or five-year period the Legislature can determine whether it wants to continue the new arrangement.

While this recommendation may appear to have the intention of usurping legislative authority, we hasten to point out that legislative oversight in property management still would exist but would not hinder the State's ability to react quickly to today's real estate market and to take full advantage of available opportunities. Further, through the oversight commitment of the Commission, both the Legislature and the Administration would be ensured of an independent, bipartisan evaluation of the Department of General Services' performance. Moreover, the State would benefit both in the short-term and the long-term from a proactive approach to managing its real property. And given the fiscal straits currently experienced by the State, it is the short-term benefits that should be scrutinized.

Steps Taken Toward Proactive Management

Opportunities currently exist for the State in its management of real property. Through activities primarily stemming from an Executive Order issued by the Governor in October 1991, the State has taken some steps toward the proactive management of its real property. The Executive Order, W-18-91, established general policies for the management of the State's real property through a coordinated central administrative process. The Order also recognized the importance of identifying property that is vacant, unused, under-used or inefficiently used. General policies established by the Order include:

- * Establishment of a preference for the State's ownership of properties whose long-term use can be anticipated, and for which the cost of ownership would be lower than the cost of long-term leasing;
- * Consolidation of its operations into joint-use facilities where possible;
- * Use of the Statewide Property Inventory as the central real estate management information system of the State; and
- * Cooperation with and development of projects jointly with the private sector.

A move toward the implementation of part of these policies is the ongoing work of the Department of General Services' Proactive Asset Management (PAM) unit. The PAM program originally was established in fiscal year 1989-90 to obtain a comprehensive view of available unused or under-used properties and to develop a specific portfolio management plan for the State's real estate. The PAM program is designed to enable the pursuit of public/private sector developments, exchanges, turn-key construction projects, and provide the State maximum dollar returns from managing long-term leases and sales of state-owned real estate.

To date, the PAM unit has completed a review of the State's owned real estate in the following four major metropolitan regions of the State: San Francisco Bay Area, Sacramento, Los Angeles and San Diego. The principal purpose of this review was to generally validate the information contained in the Statewide Property Inventory and to identify properties that appear to be under-used or surplus to the State's needs. For the purpose of this review, under-used properties were defined as those properties that:

- could be better used for other program needs;
- are capable of being used for more than one state program;

- are obsolete to such a degree that their utility is minimal; or
- are no longer suitable for ongoing state program needs.

Of the 700 properties reviewed by the PAM unit in this field review, 125 state-owned properties appear to be either under-used or inadequate for current program needs. Examples of these properties include:

- * Metropolitan State Hospital, a surplus office building and three surplus field offices of the Employment Development Department in Los Angeles County;
- * California Institution for Men and Patton State Hospital in San Bernardino County;
- * Cal Expo and Folsom State Prison in Sacramento County;
- * San Quentin State Prison and three state parks in Marin County; and
- * Industrial Relations Office Building and the Old State Building in San Francisco.

Further work has been done on some of the properties in the San Francisco Bay Area to evaluate the nature and extent of the current and projected program use, potential uses and the specific development alternatives available for each. Thus, the Department of General Services has developed a strategic plan for addressing those properties. What the department has testified before the Commission as having a need for, however, are the tools necessary to take the next step and implement the plan.

Commission staff is pleased to see that the State has taken steps in the direction of proactive management, and the studies and discussions that have occurred to date are encouraging. Yet we would be more heartened to see that some action has been taken to realize actual savings or increased revenues. Under normal circumstances, the State could not be criticized for engaging in a deliberate, strategic analysis and decision-making process that primarily considers the long-term benefits related to the handling of properties. But the State's current fiscal crisis demands faster movement on properties that clearly are under-used. To borrow a phrase, "When your house is on fire, you don't appoint a committee." In a sense, the State's house is on fire, and only the swiftest of sound decision-making should take place.

For example, the Department of General Services already has determined that many of the San Francisco/Oakland properties would be best served by using fewer buildings in a smaller geographical area of San Francisco to consolidate certain state functions, and by moving many operations to the Oakland/Alameda area. Such a consolidation and operations movement would free up other properties either to be sold or to be leased out or jointly developed. To the extent possible, action should be taken in the next fiscal year to realize savings and/or revenues from the properties that can be freed up.

The problem, however, is that the department does not have the authority to act quickly on such properties. The same holds true for the remainder of the 125 properties (not included in the San Francisco/Oakland plan) that have been identified as either under-used or inadequate for use. It would appear that some of these remaining properties, particularly the ones identified as surplus, are candidates for immediate action. Commission staff in no way endorses the wholesale selling off of any property; such action would be extremely short-sighted. But we do recommend that surplus properties be evaluated immediately for alternative uses. In some cases, the State may well benefit from the sale of properties; in other cases, it may be to the State's advantage to lease out properties or enter into a joint development with other public entities or the private sector.

By implementing Commission staff's recommendation to give the Department of General Services the authority to negotiate the disposal of surplus property, lease-purchase agreements and long-term leases, (for a limited period and subject to Commission oversight), the State could realize an immediate impact related to some of the properties that already have been identified as under-used.

Potential Impact of Immediate Action

It is difficult to quantify exactly how much money the State could save or earn in the next fiscal year through immediate action on certain properties. As an example of the financial opportunities available, though, a state property demonstration project completed in 1988 conservatively estimated that, through the commercial use of only three properties in San Diego, the State could gain as much as \$7.3 million from one-time transactions, such as sales, and from \$4.8 million to \$10.8 million annually through alternative uses, such as ground leases.

Using a "broad brush" assumption that similar findings can be gained from the current list of properties identified by the PAM unit as under-used or surplus, one can expect that additional annual revenues could accrue from alternative uses of those properties. Absent any readily

available method of evaluation, a simple extrapolation of the 1988 study results yields the following estimate for generating additional revenues next year without selling assets.

Of the 125 properties on the PAM unit's list, 32 properties specifically are identified as either surplus or under-used. Using the "broad brush" assumption mentioned above and extrapolating the 1988 study results: if 3 properties could generate between \$4.8 million and \$10.8 million, then 32 properties could generate between \$51.2 million and \$115.2 million annually.

This estimate, however, ignores a host of differences between the San Diego properties identified in 1988 and the current list of properties from around the State, including differences in property type, property value and potential for commercial use of the property. Though this estimate overlooks the complexity of evaluating property, it at least gives an idea of the magnitude of the potential yield from the aggressive management of state real property.

Conclusion

In light of the State's current fiscal dilemma, it appears that rapid reforms need to be instituted to unearth badly needed funds. In reviewing current state policies regarding the management of real property, Commission staff believes that an appropriate step to take immediately is to provide the Department of General Services with time-limited authority to dispose of surplus state lands, negotiate lease-purchase agreements and negotiate long-term leases. In addition, the department's activities over the next few years should be independently evaluated by the Commission to assure the Legislature that the objectives of the new policies are being met. By instituting aggressive policies, the State can tap the tremendous fiscal potential of alternative uses of state property.