Executive Summary

As state government seeks to wring efficiencies out of state programs and assets and demonstrate responsible stewardship to California residents, its leaders should move aggressively to modernize the state's approach to managing its developed property and vast land holdings.

Governor Brown has taken an important step in this direction, asking departments to identify unused property that could be sold and directing the Department of General Services to renegotiate leases on privately owned buildings, where possible, to take advantage of changed market conditions and to help departments consolidate government operations where vacancies in state buildings exist.

The department functions as the state's real estate agent, serving as contracted agent and broker for many other agencies. The department's distinction as the state's single largest "owner" of office buildings – rented to government agencies and departments – has given it the status of the state's landlord, though it controls only a third of the state's office buildings and only a sliver of the 6.9 million acres the state owns.

Taken as a whole, however, California's approach to property management is decentralized, with little statewide coordination, cooperation or oversight. This leaves departments unable to manage their operations efficiently, develop realistic space plans or systematically coordinate with other departments to co-locate program operations to better serve the clients they share.

The issue regularly finds itself in the spotlight when chronic budget shortfalls spark calls to find and sell off surplus property, prompting a scramble to assess and package parcels with little thought given to a long-term strategy for managing either the state's developed property or its large trust holdings.

Shortly after assuming office, Governor Brown shelved plans to sell, then lease back, several office buildings, saying that the proposed deal would cost the state in the long run.

Governor Brown since has demonstrated his willingness to reshape state government to meet new conditions and to increase efficiency, changes the Legislature has supported in adopting laws to implement realignment and allowing two government reorganization plans to go into effect.

These changes alone should persuade the state to adopt a better approach to managing state property assets, given the evolving needs of a state government in transition and opportunities presented by shifts in demand in the commercial real estate market.

State policy-makers, however, have been slow to update California's approach to property management, despite new market opportunities as well as new technology, such as geo-spacial mapping and portfolio software that can aggregate information visually and easily highlight trends, challenges and opportunities.

The Little Hoover Commission in 1995 called for major reforms in its report, *California's Real Property Management: A Cornerstone for Structural Reform*. Its findings and recommendations are still relevant.

Revisiting the issue, the Commission has found little significant change and that the state requires a far more proactive overall approach to the ongoing management of its real property – an imperative that exists separately from the need to address any short-term budget shortfall through one-time property sales.

For this study, the Commission held hearings in October 2011 and January 2012. As part of its fact-gathering process, the Commission also held two subcommittee meetings, on asset tracking practices within state agencies and departments in January 2012, and on the state's ownership of fairgrounds in March 2012.

The Commission found that the state's overall property management practices lack cohesion, lack coordination across agencies, do not produce a reliable, complete account of all of the state's holdings, and have not kept pace with innovations and opportunities adopted by private sector property management organizations. Departments pursue property planning, maintenance and management in isolation, with little

Prior Recommendations of the Little Hoover Commission

The Commission's 1995 report, *California's Real Property Management: A Cornerstone for Structural Reform*, reviewed the state's property management practices and the organizational obstacles within the Department of General Services. The report also focused on improving state construction projects.

Most significantly, the Commission found that the state's major property management problems would be difficult, if not impossible, to resolve without significant organizational restructuring. The Commission recommended the state unify its management of developed property into a new independent, yet accountable organization. It recommended the new entity be free to use market mechanisms and business practices and also be free from day-to-day political influence. At a minimum, the Commission recommended the state tear down the walls within the real estate arm of DGS, adding that the ideal scenario would be to create an independent public corporation, governed by a board appointed by the Governor and Legislature.

Source: Little Hoover Commission. December 1995. *California's Real Property Management: A Cornerstone for Structural Reform*.

centralized guidance or oversight and no financial or legal incentives to maximize the use and value of the properties under their control – either to the benefit of their programs or to taxpayers.

A fundamental problem: The state still lacks a central database that details all property in its hands. The Statewide Property Inventory, created in response to previous Commission recommendations, fails to provide an overall picture of what the state owns, whether departments are putting property to its best use, or whether opportunities exist to develop better uses for a specific holding. Given the shortcomings of the inventory, the lack of incentives for departments to develop higher value uses for state property, and the limited authority they have, the staff of the state's primary property management entity, the Real Estate Services Division of the Department of General Services (DGS), work as well as they can, according to people both in and beyond state government who have worked with the division. DGS, however, is not empowered to truly manage the state's assets proactively, using tools and strategies available to the private sector.

Challenges in California's Asset Management

The outdated organizational design and budget and policy frameworks of California's asset management system produce inherent challenges:

- A leadership vacuum on statewide asset management;
- A lack of overarching policy or strategy for asset management;
- A lack of broad planning by program or by region, with no strategic focus or direction;
- Varying levels of authority granted to different agencies and departments, leading to further decentralization of real estate decisions and actions;
- A lack of centralized and easily accessible information about the state's properties that complicates efforts to cooperate on property use;
- An outdated tracking system (the Statewide Property Inventory) that fails to show a clear and comprehensive picture of state properties;
- Misaligned incentives that perpetuate the status quo;
- Departments left to their own devices to plan for asset needs; and
- DGS charges that are higher than market rate for some services, causing departments to avoid using DGS services in some instances.

The lack of comprehensive information about the state's properties means that the state has no realistic understanding of how to value its real property assets.

The Commission's findings are consistent with a report released in 2011 by the California State Auditor, which described deficiencies in the activities of the State Lands Commission, a body that manages mineral rights, leases and ownership of much of the state's land, primarily lands beneath waterways and those that were provided to California by the federal government in the 1800s to support schools. The state auditor's review revealed that the commission had failed to collect millions of dollars in rent money due to the state because it had neglected to update rates, renew leases and take action against tenants who had not paid.

Though the State Lands Commission has taken steps to address the audit's concerns, it remains an entity unconnected to any broader effort to effectively manage state properties. The State Lands Commission inevitably must be part of a wider policy for property management.

The evolving role of state government, combined with the imperative to make the most of taxpayer dollars, require an aggressive and rigorous statewide approach to managing state property assets, whether office space, land set aside for long-abandoned projects or property leased for such private enterprises as solar farms, mining or oil and gas extraction. Such an approach also is essential for maintaining and protecting lands held in trust by the state.

This approach must produce a system that is able to efficiently identify, inventory, assess and manage state property assets in a way that is both transparent and accountable to the public. This will require the state to build capacity in policy, leadership, data collection and management and oversight.

As a first step, the Legislature should request that the State Auditor conduct an audit of all state entities to establish what exactly the state owns, and use the results as the basis for a searchable, mappable database that is easy to use both by the public and the state departments that will contribute to it. The Legislature also should direct the State Auditor to assess how well departments that manage their own office space and facilities track vacancy rates, space utilization, maintenance and repair and how their practices, including internal rent rates, and rates on property leased to non-government entities compare to the private commercial market.

The audit results should be used to develop statewide property management policy that has as its mission ensuring the state makes efficient office space and other land-use decisions to drive better program outcomes, and that state assets are managed to their highest programmatic value. While state parks and other conservation holdings should be included in the updated Statewide Property Inventory, policy development should focus on making more intensive and efficient use of developed property used in state operations, such as office buildings, maintenance yards and correctional facilities, as well as high-value assets that can produce recurring revenue for the state, such as oil, gas and mineral leases of state property. Such high-value assets require intensive management and should be integrated into a single asset management strategy.

Implementing this policy will require centralized leadership and a strategic plan informed by the experience and advice of property management experts, from both the public and private sectors.

This mission goes beyond the existing capacity and authority of the Department of General Services' Real Estate Services Division. In its 1995 report, the Commission found that the state's major property management problems would be difficult, if not impossible, to resolve without significant organizational restructuring.

Based on testimony and interviews collected in the current review, the Commission reiterates this finding. Using the government reorganization process, the Governor should establish an independent department, separate from the Department of General Services, to manage the state's office space, as well as leases for private office space, and provide other real estate services for client departments.

A new Department of Asset Management should be placed within the new Government Operations Agency, which was created by Governor Brown's 2012 Government Reorganization Plan and will become operational in July 2013. The new department's focus should be on quality service to other state departments, with the mission of maximizing the programmatic value of the state's developed property assets. Its business practices should ensure that departments make optimal use of state-owned or leased space as determined by their program needs; that state departments pay rents that are competitive to comparable privately-owned buildings and that state property assets are properly maintained to retain value.

The functions of the Real Estate Services Division of DGS should be moved into the Department of Asset Management. Rather than replicate the division's existing structure, however, the Governor should take the opportunity to reorganize these functions for greater efficiency according to industry best practices. A separate branch should be created for managing oil and gas and mineral assets, currently the responsibility of the State Lands Commission, as these high-value holdings require special expertise. Policy-makers also should look for additional opportunities to move other functions of the State Lands Commission into the Department of Asset Management.

State-owned fairgrounds pose a unique property management challenge now that the state – as of January 2011 – has stopped funding District Agricultural Associations. Without funding or state staff, local associations are on their own to manage and use the 41-state owned fairground properties. The state should address this challenge by authorizing the creation of alternative ownership arrangements, such as joint powers authorities or public benefit corporations, that would keep the property in public hands, but allow greater local control and autonomy in managing the properties.

Planning, construction, leasing and maintenance of all state office buildings should be unified in the new Department of Asset Management to allow more coordinated decision-making in meeting space needs of customer departments, better management of existing structures and the integration of modern asset management practices and technology. The new department should be responsible for compiling and maintaining the Statewide Property Inventory, and working with other state departments to assess and meet their real estate needs as part of an overall management strategy. The Governor should start the process of consolidating property management functions that exist in other departments into the new Department of Asset Management. Ultimately, the new department should be responsible leasing, maintaining and building the bulk of the state's office space.

The new department must be given the flexibility to be able to adapt quickly to changes in the real estate market, and have authority to make and enforce decisions to take advantage of market opportunities as they arise that can provide benefit to the state. To launch the new department, the Governor should form an advisory committee of experienced private sector property management professionals to help the department adopt and adapt industry best practices and technology that have proven successful in the private sector. The department should be authorized to hire real estate and asset managers into exempt positions and be able to enter into contracts with private management firms where doing so benefits the state.

One goal of the department should be self-sufficiency, which will require allowing the department to retain rental revenues so that it can reinvest in state assets, whether maintenance and repair or renovations needed to accommodate new uses or new tenants. Such funds also should be used, when available, to help pay moving costs involved in consolidating government operations into underused or vacant state-owned office space. As one facet of its ongoing property management role, the department should be responsible for identifying and disposing of surplus state property, with such one-time proceeds used to pay down debt, applied to the state's maintenance backlog or put toward new construction. The appropriate statutes and regulations should be adjusted to give the department the authority to develop a disposition list of properties to be sold. The properties would be put up for sale unless the Legislature acted within 90 days of receiving the list to stop the sale.

The modernization of the state's property management system is long overdue. California's developed property and its trust holdings must be managed in a way that maximizes their long-term value to the programs they serve and to Californians present and future. An effective strategy will require harnessing the expertise that exists in the ranks of state departments with the experience and best practices honed over decades in the private sector. Above all, it will require leadership with the ability to balance enterprise and stewardship to navigate the challenges of the present for the benefit of future generations.

Recommendation 1: The Legislature should request that the State Auditor conduct an audit of all state properties held by California state government departments, boards and commissions. The results should be used to update and enhance the Statewide Property Inventory.

- The audit should determine how much property the state holds by department and detail how the property is used. The audit also should detail how much property each department leases from private landholders.

- The audit should describe the current property management and leasing procedures and policies of departments that control state office space and other developed property for their operations. The audit should detail vacancy rates, space utilizations and rent, as well as comparable private property rents. For departments or government entities that lease or rent state property to non-governmental entities, the audit also should describe how lease payments and contracts are monitored for timeliness, and how rates are adjusted to comparable market rates, as well as vacancy rates and space utilization of leased property.

Recommendation 2: The Governor, through the reorganization process, should create a Department of Asset Management within the Government Operations Agency, separate from the Department of General Services, to serve as the central state authority for managing California's real property assets, drive innovation to maximize state property assets and provide accountability to the public.

- The new department should be the repository of the Statewide Property Inventory and should be provided the resources to make the inventory a foundational tool of the state's property management strategy. The inventory must have an online interface designed to facilitate accessibility and ease of use for the public.

- The Governor should start the process of consolidating property management functions in state departments into the new department, ultimately bringing all state property management functions under the new department's control.

- The Governor should form a board of advisors made up of experts from California's top private sector property management firms that can help the state integrate up-to-date business practices and systems into the state's property management operations. The board should sunset after a fixed term. Members should serve as volunteers.

- The board of advisors should meet quarterly to review the department's business plan and ensure that the department is adopting and following best industry practices.
- Current Real Estate Services Division staff and functions should be moved into the new Department of Asset Management from the Department of General Services. Based on guidance from the board of advisors, the division should be functionally reorganized to align with best industry practices.
- The department should be the lead on identifying and disposing of surplus state property. Each year, the department should submit a disposition list of surplus property to the Legislature and sales should go forward unless the Legislature acts to stop them within 90 days of receiving the list.
- Proceeds from one-time sales should be applied to debt reduction or other one-time outlays.
- The Legislature should develop clean-up legislation that clarifies the distinction between "excess" and "surplus" property.
- The department should have the authority to reinvest rental income from state departments into repaying lease-revenue bonds as required, maintenance, or renovation to accommodate new needs or new state tenants.
- The department should have the flexibility to hire exempt employees to train and build management capacity and expertise, particularly in enterprise areas such as high-value leases.
- Once the department has management expertise in place, the administration and management of high-value oil, gas and mineral leases should transferred from the State Lands Commission to the Department of Asset Management.
- The new department should lead the effort to develop a comprehensive asset management policy, as recommended below.
- The new department should annually publish a report that explains how the department has enhanced asset management in the state, with specific performance measurements such as the revenue generated from state assets, office space cost per employee, average square-foot of space per employee, total

buildings sold and consolidation of office space use by departments.

Recommendation 3: California should create a clear asset management policy to guide property-related decisions by the Department of Asset Management and across state departments.

- The Department of Asset Management should serve as the central forum for drafting a comprehensive asset management policy for California, seeking input from others, including all asset-controlling departments, private-sector partners, the Department of Finance and other interested persons.
- Asset management policies should be codified in legislation to ensure permanence and enforceability.

Recommendation 4: The Legislature should enact legislation that provides more flexibility to district agricultural associations to pursue strategies that support and sustain the mission of local fairs.

- The legislation should enable the state to transfer state-owned fairground property to a joint powers authority, whose membership includes the district agricultural association and local governments, established to keep the property in public hands and expand options for communities that support the association's missions and local economies.