CALIFORNIA STATE GOVERNMENT'S MANAGEMENT OF REAL PROPERTY

EXECUTIVE SUMMARY

The State of California is one of America's largest property owners and property managers. Specifically, California owns more than 65 million gross square feet of space in buildings of all types including offices, warehouses, prisons, museums, hospitals, garages, equipment storage sheds, records archives, and other types of constructed space. The State leases an additional 8 million square feet of office space statewide to accommodate State operations. Conservative estimates place the total replacement value of the more than 10,000 buildings owned by the State at somewhere between $1.35 billion and $2 billion. We believe the total value is substantially higher.

California is also a major landowner, currently holding more than six million acres. An unknown number of State-owned land parcels are located in prime real estate markets in metropolitan areas from San Francisco to Los Angeles and San Diego, from Redding to Fresno and Bakersfield.

More than 2,600 individuals are employed by the State to manage, clean, repair, and alter State-owned and State-leased facilities at a total cost of more than $160 million annually. The State pays an additional $385 million annually for "facilities operations" and utilities.

WHY STUDY PROPERTY MANAGEMENT IN CALIFORNIA STATE GOVERNMENT?

Given the proportions of property management in State government, the need for systems to effect cost controls and efficient management is clear. A major study of real property management in the Federal government, however, had concluded that the Federal approach to property management was antiquated and, as a result, was wasting literally billions of dollars.

Nathan Shapell, Chairman of the Commission on California State Government Organization and Economy -- also known as "the Little Hoover Commission" -- was also a member of the Special Commission appointed by President Reagan to conduct a Private Sector Survey on Cost Control in the Federal Government. (The President's Commission was chaired by Peter Grace, Chairman of the Board of the W.R. Grace Corporation; that Commission, now disbanded, is still frequently referred to as "the Grace Commission.") Mr. Shapell co-chaired the Task Force on Real Property Management within the Private Sector Survey and, based on the Task Force's findings, urged the Little Hoover Commission to undertake a similar study of California's property management systems. Recognizing the substantial potential benefits to California taxpayers, the members of the Commission undertook the study which led to the following major conclusions and specific findings.

STATE PROPERTY MANAGEMENT IS NOT STRATEGIC

California's approach to property management is "custodial" rather than strategic. It is premised on a static view of property ownership in which property is seen almost exclusively as a cost. A dynamic view of property ownership recognizes property as an asset whose value in exchange can yield revenues that exceed a given property's value in its present use. The Commission has coined the term "pro-active assets management" to refer to the strategic approach to property management we believe should be instituted in State government.

The benefits of pro-active assets management can be quantified in dollars and cents. Due to the potential magnitude of cost savings and revenue increases, we urge the Governor and Legislature seriously to consider our recommendations. Revenue increases from pro-active assets management are of particular interest because, not deriving from taxes paid to the State, they do not affect the "Gann" limits on appropriations.

For example, we estimate the State could save a minimum of $34.8 million in "occupancy costs" over three years by setting and accomplishing quite modest cost control goals. Additionally, we have identified specific land parcels currently underutilized by the State but located in prime real estate markets where their combined value is in the tens of millions of dollars. Other "surplus" properties could be sold generating hundreds of millions of dollars.

The Commission does not advocate wholesale disposition of State-owned land and buildings without regard to government's responsibility to conserve public assets for future generations. Rather, our position is that California State government has made a substantial investment in real property on behalf of California taxpayers. We believe the State has an obligation to manage this property efficiently and to produce earnings on this investment to whatever extent possible. We further believe the State must be accountable to the public for the strategic management -- not mere custody -- of real property, recognizing it as the extremely valuable asset and resource it is.

Our specific findings leading us to conclude that California's property management is not strategic include the following:

FINDING #1: State Property Management Is Accountable to No One and Is Out of Control: Organizational structure for property management is confused. The Department of General Services (DGS) is unsure whether its primary mission is control or service; consequently, it is not structured or "positioned" to meet either goal. Its confused "positioning" reflects the existing degree of decentralization of property management functions throughout State government -- despite current laws and articulated policy statements which identify DGS as the State's property manager.

Controlling costs of occupancy is currently impossible. Cost categories lack standard definition and, therefore, expenditures in these categories cannot be readily monitored.

The absence of control combined with confused definitions of responsibilities has led to overlap and duplication. The degree of staff duplication is difficult if not impossible to determine, due to: (1) inconsistencies in DGS vs. "non-DGS" job descriptions and in the quality of services available from DGS; (2) independent statutory authorization for isolated property management functions; and (3) undisciplined decentralization.

FINDING #2: Foregone Revenue on Selected Properties Reaches a Minimum of Hundreds of Millions of Dollars: In 1983, the Auditor General estimated the value of excess lands owned by only four State agencies at $164 million. Over the course of our own study, real estate consultants and brokers brought to our attention the following additional examples:

* Six acres in Thousand Oaks near the intersection of Routes 23 and 101 which have been declared "surplus" by Caltrans. Estimated market value: $200,000 to $300,000.

* Two three-acre parcels near the Route 22 entry onto 7th Street in Long Beach. Estimated market value: approximately $3 million.

* Approximately two acres on the corner of Wilshire and Sepulveda in Los Angeles, currently used as a Caltrans vehicle yard. Estimated market value: $15 million.

Because the State makes no routine effort to determine the potential sale price of State-owned property that would be appropriate to sell or lease, the number of revenue opportunities foregone and the magnitude of their dollar value are unknown. This is not surprising, given that State property managers have no structured incentives to look for such opportunities.

FINDING #3: The State's "Custodial" Management of Property Does Not Sufficiently Analyze Nor Consider Alternatives for the Highest Economic Return from Real Property: Maximizing return on investment appears to receive no consideration in the State's property management decision making. The State does not investigate leasing arrangements or restructured ownership options for appropriate properties which experts suggest could generate one-time revenues of millions of dollars.

Moreover, the State owns and uses valuable land for low economic return purposes when less costly alternatives are available. For example, the State owns land used now for State employee parking in downtown San Diego. Commercial brokers estimate this lot could be leased to private developers for $500,000 per year. State employees now pay $21.00 per month to park on this State-owned land, but more than sufficient parking space is available within a 5-block area for $25.00 per month.

A second example is found in Sacramento itself. Parcels of land surrounding Cal-Expo have become extremely valuable due to commercial development that has occurred around the fairgrounds. In January 1986, the Auditor General reported the fair market value of parcels that could be sold for $41 million or leased for approximately $4 million annually without negatively affecting the State Fair.

FINDING #4: Custodial Property Management Could Jeopardize the Value and Optimal Use of Public Buildings: To the extent "custodial" property management fails to place a high enough priority on maintenance and repair of State-owned buildings to assure that the value -- much less the safety -- of those buildings does not deteriorate, the State is engaging in short-term cost reduction programs that could jeopardize optimal use of State-owned public buildings in the future. Although there is broadly based agreement that "deferred maintenance" has reached major proportions, the ability of the State to define a strategy for catching up with deferred maintenance while sustaining an adequate program of routine and preventive maintenance is thwarted by lack of consistency in cost category definitions and the low priority assigned to such projects in the budgetary decision making process.

FINDING #5: State Ownership of Real Property Imposes a Hidden Tax Every Year of Approximately $20 Million on Local Communities: We agree that State ownership has many advantages: building up of equity, assurance of public accessibility, and the potential for attaining better coordination of and greater efficiency in State operations, among others. When strategically managed, State property ownership can greatly benefit California's taxpayers. But, to the extent the State fails to generate earnings on its substantial real property holdings, State ownership of land and buildings in any given community imposes an unevenly distributed and significant hidden tax on local taxpayers.

FINDING #6: State Property Management Lacks Access to Essential Expertise: Real estate investment and development is one of those professional specialities whose experts generally seek success in the private rather than public sector. The freedom to negotiate, combined with the potential to earn substantial profits from a skillfully negotiated "deal" make this type of enterprise alien to the bureaucratic rules and civil service constraints required in government.

Strategic property management in State government would be concerned with forging a "public-private partnership" in which private sector specialists could be retained to provide services on the public's behalf. With respect to leasing, for example, we found that all of the State's leasing agents and space planners are based in Sacramento. We believe this arrangement fails to maximize the opportunities created by familiarity with local markets to obtain favorable lease terms for tenants.

A related problem has to do with the level of training among the staff currently responsible for managing the State's property. We found that building managers and business service officers are inadequately prepared to implement a pro-active assets management program.

STATE PROPERTY MANAGEMENT FAILS TO IDENTIFY MEASURABLE OBJECTIVES AND PROVIDE PERFORMANCE INCENTIVES FOR THEIR ACCOMPLISHMENTS

The importance of properly structured incentives to implementation of pro-active assets management cannot be overstated. Consequently, we are discouraged by the striking lack of incentives inherent in the existing State property management system. We believe this "incentives problem" is part of a larger problem, namely that there currently are no measurable objectives for State property management because there is no structure for accountability. Our conclusion regarding lack of proper incentives is based on the following findings:

FINDING #7: Bigger is Better in State Government: Private sector property managers are given an incentive to reduce occupancy costs and to maximize economic return on their companies' investments in real property, because they can expect to share in the profits such accomplishments yield. State-employed property managers, in contrast, can benefit personally not through pro-active assets management, but by obtaining budget increases. Although budgeting is conducted in an adversarial environment, control agencies mysteriously assume managers consider it part of the job to cooperate in reducing State costs, without recognition or reward.

FINDING #8: State Employees Lack Incentives to Reduce Costs: Although there is a "suggestion program" whereby individual employees may receive proportional benefits from savings achieved through implementation of their suggestions, the annually adjusted compensation system for State employees historically has provided no reward system to encourage efficiency. In fact, reducing the cost of State operations can cost a manager a pay increase, because managerial employee level and salary are based on the number of employees one supervises rather than on performance outcomes.

The Department of Personnel Administration (DPA) in October 1985 announced a new program of offering bonuses for "managerial performance." Clearly, the Commission endorses this concept, but we believe DPA's program will fail to encourage excellence in management generally because it is not related specifically to measurable objectives. Rather, eligibility for bonuses is to be determined by the number of calendar days a manager has spent in the position being evaluated.

STATE PROPERTY MANAGEMENT IS NOT SYSTEMATIC

The ambiguity of what State government wants to accomplish in general through a property management system had led to an overdevelopment of procedures, a proliferation of forms, and indiscriminate data collection -- means of staying busy when it is not clear what is supposed to be getting done. Ambiguity prevents opportunities for State property managers to see their mistakes and correct them and/or measure their effectiveness. Lacking mechanisms for meaningful self-evaluation, State property management continues to accumulate a full complement of standard bureaucratic procedures, but falls short of becoming a system.

The findings listed below led us to conclude that State property management is not systematic:

FINDING #9: Planning in a Custodial Property Management System Resembles Planning in a Vacuum: Pro-active assets management requires strategic planning. By definition, planning is an inexact science, but a strategic management system would be concerned with setting attainable goals under conditions of uncertainty and quantifying progress made in reaching those goals. Furthermore, based on measured progress, a strategic management system would offer incentives for making the extra effort to improve accuracy.

State property management neither sets attainable goals nor makes an effort to quantify progress. As a result, it is impossible for State property managers to see mistakes they have made, for example, in projecting the State's space needs. Furthermore, it is of no consequence whether such projections are accurate or inaccurate or come anywhere close. Over a six-year period, the State came closest to projecting actual space requirements for 1982-83, although actual need that year exceeded the projection by 75.5 percent. Having to make selections of office space at the last minute, probably in leased facilities, can reduce the number of options available and thereby increase the cost of space -- in effect, putting the State at a disadvantage in what should be a lessee's market.

FINDING #10: The State's Inventory of Real Property Is Inaccurate and Incomplete: The Department of General Services maintains an automated inventory of space which is occupied for State operations, as well as a proprietary land index (most recently updated in mid-1982). The inventory contains information which is clearly useful but incomplete; in some cases, the data appear to be either inaccurate or simply out of date.

We conducted a survey of State departments occupying 50,000 square feet or more of office space in 1984-85. Out of 111 possible comparisons with DGS's data, there were only seven instances -- 6.3 percent of all data cells -- in which the figures reported by individual departments were the same as those which appear in DGS's inventory. Four of those seven were agreements on a "zero" response. Table A-1 in Appendix A provides a detailed comparison.

FINDING #11: Automated Data Processing Is Not Utilized Systematically for State Property Management: The State underutilizes its existing automated data processing (ADP) capabilities in at least three ways. First, the distribution and use of ADP resources are uneven and uncoordinated: based on responses of the surveyed departments, we conclude existing ADP systems decentralized to property managers at the department level do not "talk to each other," obstructing the development and maintenance of a comprehensive and accurate inventory.

Second, applications of ADP capabilities are unrelated to property management objectives: the State collects an impressive quantity of data pertaining to operating and overhead costs for public buildings but fails to use the data to improve accuracy in budgeting or to compare performance with objectives.

Finally, priorities for ADP utilization appear not to have been determined: we found errors of addition in DGS's cost analysis for building operations. The errors were significant because they made the difference between being able to see that, instead of declining by half a million dollars, costs had actually increased by that amount. The type of error detected was clearly the result of analyzing massive amounts of cost data using a calculator rather than an electronic spreadsheet.

FINDING #12: Management of "Space Action Requests" Is Unwieldy and Slow: The Commission conducted a case study of "Space Action Requests," drawing a random sample from DGS's file of completed transactions over a two-year period (see Appendix B of the report for a detailed description of findings and methodology). The case study led to conclude that (1) internal documentation is unwieldly; (2) the Office of Space Management lacks an effective project management system; and (3) processing time is slow.

RECOMMENDATIONS

A. Authorize Pro-Active Assets Management Pilot Project

We recommend implementation of a pilot project to (1) develop the parameters of an information base needed for pro-active assets management, and (2) produce an estimate of the "opportunity cost" (cost of inaction) of maintaining in its present use all State-owned property within the designated pilot project area.

The Department of General Services should have overall responsibility for selecting the consultant and administering the pilot project. The consultant's responsibilities should include:

1. Development of an information base appropriate for pro-active assets management

2. Identification of "segments" for State-owned property and their order of priority for disposition on the basis of specified criteria

3. Cost-benefit analysis of alternatives for selling, exchanging, or re-structuring ownership of land and/or buildings owned by the State

4. Identification of options for generating revenue on the State's real property

5. Proposal for a model pro-active assets management system within State government, including cost control and performance incentive structures for meeting recommended strategic goals

6. Assessment of bureaucratic resistance to pro-active assets management

7. Analysis of current State and Federal laws pertaining to public sector pro-active assets management

8. Analysis of public policy implications of public sector pro-active assets management

B. Structure Organizational Accountability

We recommend that the Governor and Legislature cooperate to adopt an organizational structure for State property management which establishes mechanisms designed to assure accountability of decision making. The new structure should be characterized by:

1. Centralization of policy development in the Department of General Services

2. Decentralization of operational planning in the 14 property-owning departments other than DGS but with the participation and assistance of DGS and, ultimately, with DGS's approval of individual departments' operational plans

3. Publication of an annual report on property management accomplishments

4. Coordination of automated data processing

C. Structure Performance Incentives to Be Related to Measurable Objectives

We recommend that the Governor direct the Departments of Finance, General Services, and Personnel Administration to develop guidelines for awarding incentive pay to State property managers. We recommend that these guidelines and eligibility for incentive pay apply only to property managers in the Department of General Services and the 14 other property-owning departments.

D. Reduce Staff Duplication

We recommend that the Governor ask the Director of Finance to analyze the current staffing level for property management in State government.

E. Create Central Automated Inventory of Real Property Occupied for State Operations

We recommend that the Governor and Legislature adopt budget control language in the Budget Act of 1986 to require the Department of General Services to develop by December 15, 1986, a plan for completing a central automated inventory of State-owned and State-occupied property.

F. Increase Efficiency of Processing "Space Action Requests"

We recommend that, in order to increase efficiency of processing "Space Action Requests," the Department of General Services identify and delete non-essential data, simplify flow of documents, design data summary forms appropriate for interface with automated information systems to assure timely data storage and retrieval, and set strategic goals for lease management.

G. Train State Property Managers

We recommend that both building managers and business service officers be required to complete the Building Owners and Managers Association's training course and receive designation as Real Property Administrators in order to be eligible for promotion to, or retention in, supervisory positions in either civil service classification. We further recommend that the State Personnel Development Center analyze the additional property management training needs of State building managers and business service officers and develop a curriculum and class schedule for these civil service classifications to be offered in State fiscal year 1986-7 and thereafter.

H. Establish Master Contracts Process for Special Services

We recommend that the Department of General Services establish a bidding process to select in multiple areas around the State special services contractors who pre-qualify under the terms of a master contract. Separate master contracts should be executed to obtain at least but not limited to the following services:

* Emergency building repairs

* Lease brokerage

* Real estate market analysis

I. Report Value of and Income From State's Property in the Governor's Budget

We recommend that the Governor direct the Department of Finance to report in the annual Governor's Budget the estimated value of property owned by the State and current revenue derived from State ownership -- as such information becomes available -- both for the State as a whole and for individual departments.