SALE/LEASEBACK OF STATE-OWNED BUILDINGS
BACKGROUND

ABx4 22, signed by Governor Schwarzenegger on July 28, 2009, authorized the Department of General Services to sell the Orange County Fairgrounds and to sell 11 other state-owned buildings or complexes. The facilities, all office buildings that house state agencies ranging from the California Supreme Court to the Franchise Tax Board, are located throughout the state: Five are in Sacramento; two are in San Francisco; two are in LA; one is in Oakland; and one is in Santa Rosa. The legislation requires DGS to sell the buildings at fair market value, and to report the proposed details of any sale to the fiscal committees of the Legislature 30 days before executing a contract. Sale conditions will require the state to lease the office space in the buildings for at least 20 years.

The legislation was sponsored by the Schwarzenegger Administration and intended to address the state's budget deficit. The Administration projected the state would earn $661 million in profit off the sale of the buildings, or about 3 percent of the current deficit of $19.9 billion.

Through a competitive bidding process, the Administration retained the real estate firm CB Richard Ellis to conduct the sale. CB Richard Ellis will earn .08% of the total sales price, which would be approximately $1.6 million, should the state receive the amount - $1.98 billion - it estimates it could receive. CB Richard Ellis prepared documents describing each of the buildings and showed the buildings to potential bidders.

Bids were due April 14, but DGS will not provide information on the number of bidders or the proposals. DGS will testify at the hearing and has been asked to provide a timeline of upcoming events regarding this issue. Proposed terms of the sale include:

- A lease term of 20 years;
- Lease rates automatically increase by 10 percent every five years. In addition, rates could increase annually based on inflation;
- Lease terms can be extended for as long as 30 more years;
- The state pays for gas and electricity, and occasional painting and re-carpeting costs, while the private owner pays for sewer, trash disposal, water, and other property management services, such as custodial services.

An investigation of the proposed sale of the state-owned buildings by the Assembly Committee on Accountability and Administrative Review has raised the following concerns:

- ***There was little economic analysis done to fully understand the costs and benefits of the sale.*** The Schwarzenegger Administration released this proposal to the Legislature on July 11, 2009, as part of an 8-page proposal outlining five potential scenarios to increase state revenue by tapping into the state's real estate assets. In the document, the Administration describes the sale and leaseback proposal in five paragraphs, and projects that the state could earn $600 to $675 million by selling buildings. There is almost no mention of the cost of leasing office space from a private owner. One sentence notes, "This avenue does carry the potential for future rent increases to the state."

According to DGS officials, the Administration selected the buildings it proposed to sell based on how attractive the buildings would be to potential buyers, and therefore how much revenue the state could receive from a sale, and not on total costs and benefits of selling the buildings and leasing the office space back from a new owner.

The Legislative Analyst's Office will present a cost-benefit analysis at the hearing.

- ***There was little public discussion of this issue before it was approved.*** ABx4 22 was amended on July 23, 2009 to include language authorizing the building sale. The list of buildings authorized for sale – and the description of the sale – do not appear until page 7 of the 11-page bill. The legislation was signed five days later by the Governor. The majority of the legislation refers to the authorization of the sale of the Orange County Fairgrounds.

- ***The sale of state-owned buildings reverses four decades of state facilities planning policy, which favors ownership of buildings over leasing office space.*** Dating as far back as 1973, state-sponsored cost-benefit analyses of leasing office space versus owning office space have consistently shown that owning office space is better for taxpayers. A 1973 audit concluded owning was cheaper than leasing, as did a 1997 Sacramento Regional Facilities Plan created by DGS. In addition, Regional Facilities Plans for Los Angeles and the San Francisco Bay Area in the early 1990s that were intended to examine the most cost-effective method for state office space expansion concluded that constructing and owning new buildings was better than leasing office space. The 1993 "Facilities Planning and Needs Assessment Study – Los Angeles Basin" noted that at the time, the state had 250 leases in Los Angeles County alone. Conclusions reached in that study led to the construction of the Junipero Serra State Building in downtown Los Angeles – one of the buildings now up for sale.

Based on these analyses, Executive Orders regarding state real estate issued by both Gov. Pete Wilson (Executive Order W-18-91) and Gov. Gray Davis (Executive Order D-46-01) indicated state real estate policy should be based on the principle that owning state buildings was preferable to leasing them.

- ***The sale would greatly reduce the amount of state-owned office space, and is scheduled to occur before the Department of General Services has a complete understanding of how the state currently uses all of its office space.*** According to information available on the DGS web site, the state currently leases 16.4 million square feet of office space and owns 39.3 million square feet. Thus, the state owns about 71 percent of the office space it uses, and leases 29 percent. Should the state complete the proposed sale of more than 5.6 million square feet of office space, the state would own 60 percent of its office space, and lease 40 percent, leaving the state more vulnerable to long-term rental market fluctuations.

Additionally, another provision of ABx4 22 requires all state agencies to submit more detailed information to DGS regarding all of the property it owns and leases, including current uses of the owned and lease space and whether the property is fully utilized. The information is due every July 1, beginning this year. This will allow the state, for the first time, to have a thorough understanding of how it utilizes all of the property it pays for. Selling more than 5.6 million square feet of office space before DGS has had a chance to analyze this information may hinder the state's ability in the future to determine the most cost-effective way to use its office space.

- ***The slumping real estate market – and other factors - may cause the state to earn less for the buildings than anticipated.*** The state's recent failed attempt to sell the Orange County Fairgrounds may indicate that the Administration's estimates regarding the buildings' potential sale prices may be wrong. In that case, the top bid was $56.6 million, significantly lower than the original estimate, which was between $96 and $108 million. In addition, an April 14 article in the Wall St. Journal noted that California's financial difficulties may discourage potential buyers, and a financial expert quoted in the article suggested the buildings' prices were too high. Office vacancy rates in Los Angeles, San Francisco and Sacramento are high – 15. 7 percent in Los Angeles, 17.7 percent in San Francisco, and 16.2 percent in Sacramento – indicating a depressed commercial real estate market, which may drive down office prices. Santa Rosa's office space vacancy rate is 13 percent, while the vacancy rate in Oakland is very low – 2.8 percent.

- ***The Schwarzenegger Administration has removed members of regional state building authorities who have questioned the sale.*** The Los Angeles State Building Authority and the San Francisco State Building Authority were created to oversee state-owned buildings and to help conduct facilities planning in the two regions. The agencies consist of three appointees, with two appointees named by the Director of the Department of General Services and the third member being the head of the Community Redevelopment Agency. Both authorities would need to approve the sale of the Los Angeles and San Francisco buildings.

Four members of the agencies – two in Los Angeles and two in San Francisco – were removed and replaced by DGS in March. All of the appointees who were removed had served on the agencies past their 8-year terms. Two of the ousted appointees will testify at the hearing. They have raised questions about the sale of the buildings and feel they were removed from their positions due to their concerns.

Jerry Epstein, who had served on the Los Angeles State Building Authority since 1983, asked the general counsel for the Authority to write a letter to DGS in February asking for a cost-benefit analysis to ensure selling the Ronald Reagan State Building and Junipero Serra State Building were in the best long-term interests of the state. He received no response except a two-sentence letter on March 17 from Ron Diedrich, Acting Director of DGS, informing him that he had been replaced.

Don Casper, who had served on the San Francisco State Building Authority since 1993, questioned the sale of the San Francisco Civic Center buildings and the Public Utilities Commission building in a February article in the SF Weekly newspaper. Casper was replaced on March 3.

SALE/LEASEBACK OF STATE-OWNED BUILDINGS OPERATIONS AND MAINTENANCE COSTS

During the course of this investigation, the Committee on Accountability and Administrative Review received information on the Operations and Maintenance (O&M) costs of the 11 state facilities that are being considered for sale. O&M costs include staff costs, utilities costs and repair costs. The information, prepared for the Legislative Analyst's Office by the Department of General Services, indicates dramatically different costs for some state buildings, and rapidly rising costs in some of the buildings.

For example, three facilities – the California Emergency Management Agency Building, the Franchise Tax Board Complex, and the Public Utilities Commission Building – had O&M costs that grew by double digits annually during the four-year period. One building – the Judge Joseph A. Rattigan Building – decreased O&M costs during that period. And buildings in the same regions, often very close together geographically, had markedly different O&M costs per square foot.

A more thorough analysis of O&M costs for state buildings could help the Department of General Services and the Legislature better understand the reasons for these costs and lead to better management of the buildings.

Below is a spreadsheet indicating the cost per square foot of the buildings, as well as growth in costs during a recent four-year period (Fiscal Year 2005-06 through 2008-09):

Operating and Maintenance Costs

Building	City	Rentable Square Footage	Annual Costs (FY 08/09)	Cost per Square Foot	Percent Growth in Cost (FY 05/06 - 08/09)
Attorney General Building	Sacramento	307,396	$1,932,841	$6.29	5%
Cal EMA Building	Sacramento	107,004	$785,220	$7.34	22%
Capitol Area East End Complex	Sacramento	1,111,167	$9,312,516	$8.38	6.60%
Justice Building	Sacramento	276,112	$5,245,247	$19.00	3%
Franchise Tax Board Complex	Sacramento	1,525,152	$11,887,885	$7.79	14.20%
Elihu M. Harris Building	Oakland	544,625	$5,489,518	$10.08	8.90%
Public Utilities Commission Building	San Francisco	210,453	$1,967,936	$9.35	19.60%
San Francisco Civic Center Buildings	San Francisco	676,097	$9,992,431	$14.78	9.20%
New Junipero Serra State Building	Los Angeles	324,312	$3,346,227	$10.32	7%
Ronald Reagan State Building	Los Angeles	515,390	$7,899,469	$15.33	8.20%
Judge Joseph A Rattigan Building	Santa Rosa	61,114	$1,011,713	$16.55	-2.60%