SPC AUDIT POLICY IMPLEMENTATIONS
(October 2012)

With the creation of the position of State Property Officer and the enactment of legislation realigning the management of the State's capital assets in 2005, the State Properties Commission (SPC) was designated as Georgia's real estate portfolio manager. SPC is responsible for the acquisition and disposition of all State-owned real property and real property interests. Additionally, SPC provides a full array of leasing services to State entities in commercially leased space. SPC also is equipped to conduct studies, research and evaluations and to provide statewide policy leadership and coordinate master planning to guide and implement capital asset management.

The State's current inventory of buildings, leases, and lands consists of approximately:

- 15,000 state owned structures
- 1,800 state leases
- 1.1 million acres state owned and leased land
- $27.5 billion of insured capital assets

The Georgia Department of Audits and Accounts issued a Performance Audit Operations report in January 2012 (Special Examination 11-33). The audit report issued a number of recommendations for improvement. The following identifies how SPC has addressed those recommendations.

I) Audit Recommendations for Improvement:

In order to effectively manage the state's real estate portfolio, SPC needs to improve the accuracy and completeness of the BLLIP database.

Specific Audit Recommendation:

Establish quality control guidelines and review procedures for BLLIP data entry to reduce varying procedures and field interpretations among the various users and entities with permission to edit BLLIP records.

SPC's Implementation:

- The user list that allows for the editing of BLLIP has been reviewed and updated – effective as of Spring 2012. Retired and former state employees have been removed from the list and new agency employees in need of access have been added. The list is actively maintained by each agency.

Specific Audit Recommendation:

Strengthen information system controls for critical fields in BLLIP to prevent entry of erroneous values and make certain fields mandatory for record submission, particularly those related to use, occupancy, cost and square footage.

SPC's Implementation:

- Mandatory (required) fields in BLLIP have been revised for Buildings, Leases and Other Assets to ensure record submission and system controls for critical fields in BLLIP.

Specific Audit Recommendation:

Conduct periodic data quality reviews to detect obvious errors and blank values in the data.

SPC's Implementation:

- SPC has developed and has underway a formal process for BLLIP data "quality control" where each month a sample of buildings is selected and a site visit is made to verify the accuracy of the building information in BLLIP. If there are any inaccuracies or blank fields, the custodial agency is then asked to make the necessary changes in BLLIP. Each month this process is documented in a BLLIP Building Inspection Report which is available on file. To date, 31 properties have been reviewed with all necessary corrections being made.

Specific Audit Recommendation:

Work directly with the state entities that represent the majority of missing and inaccurate data to improve data completeness and accuracy.

SPC's Implementation:

- In an effort to correct missing and inaccurate data in BLLIP, SPC contacted a total of 27 agencies that were identified based on six key fields that were either lacking data or in need of updating one or more of the building key fields. Additionally, SPC met in person with the eight agencies that represented approximately 90% of the missing data in a focused effort to gather complete information. In all but two agencies (Department of Natural Resources and the Board of Regents), those fields lacking data or in need of updating have been corrected. In addition, SPC reviews the six key fields monthly to ensure data accuracy going forward.

Specific Audit Recommendation:

Add a field to identify unused (vacant) versus used space and limit the use of occupancy rate fields to the primary use categories for which occupancy calculations are relevant.

SPC's Implementation:

- Capacity/Occupancy information is now captured in BLLIP for office property use only. This is in an effort to better assess utilization of state-owned and leased office assets. Buildings that are not classified as office use (storage facilities, classrooms, auditoriums, etc.) have the field "Use" with a drop-down option titled 'Approximate % Utilized' with the following options, 0%, 20%, 40%, 60%, 80%, 100%, from which to select.
- We have modified the "use types" and eliminated 'Leased to a non-state agency', 'Other use(s)', 'Land/Acreage' and 'Vacant' from the menu of choices meant to describe the building property use.

Specific Audit Recommendation:

Determine the most efficient and effective way to collect and maintain data necessary to calculate costs associated with state owned buildings.

SPC's Implementation:

- This is an ongoing process for SPC that has involved discussions with the State Accounting Office and the Governor's Office of Planning and Budget to identify ways that real estate costs can be identified and allocated on an individual property basis. In addition, SPC is working with Georgia Environmental Facilities Authority which is in the process of identifying all the utility providers and accounts for state-owned properties. We continue to pursue ways to allocate costs by property in order to better measure individual building costs.

II) Audit Recommendations for Improvement

The State Properties Commission needs to develop stronger policies and procedures related to the factors that impact the state's lease costs.

Audit Recommendation:
Consider requesting more statutory authority over leases negotiated by exempt entities. For example, SPC could provide independent oversight over high-cost leases that exceed defined limits and could work with agencies to establish parameters for reviewing costs.

SPC's Implementation:

- Multi-year leasing legislation passed the General Assembly in 2012 and an amendment to the State Constitution will be voted on in the November general election. The law will also require the Department of Labor and Board of Regents to

come through SPC to enter into a multi-year lease, thereby giving SPC more control over the total lease portfolio.

Audit Recommendation:
Improve its analysis of backfill opportunities in state-owned space before leasing private space. SPC should (a) establish policies and procedures to define staff requirements for assessing state-owned property inventory and (b) require documentation of the analysis to be maintained as part of the lease file.

SPC's Implementation:

- SPC modified its internal tracking system to include two check boxes in the Space & Transaction Management Tracking System (SATMT) to document staff consideration of vacancies in state-owned space and other back-fill opportunities.

Audit Recommendation:
Write procedures explaining the goals and standards to leasing. Specifically SPC should establish procedures detailing the data collection and analysis techniques that staff should execute to identify private property for state entities to lease.

SPC's Implementation:

- SPC's Transaction Management – Leasing Division has written standard operating procedures that specify standard procedures for 1) new lease requests, 2) renewal of existing leases, 3) renegotiation/modification of existing leases, and 4) cancellation of existing leases. These procedures were reviewed at a February 16, 2012 meeting with agency personnel and have been posted on the SPC website.

Audit Recommendation:
Adopt criteria to evaluate the merits of a requesting entity's stated geographic location requirements and adopt procedures to formally document SPC staff considerations of general geographic area (and the associated cost implications) as part of the lease file.

SPC's Implementation:

- SPC relies on the agency to determine the best general location that will serve its program requirements. SPC and the user agency will then work together to determine the best location based on the leasing costs and the agency's program requirements and business needs. If the agency deviates from SPC's recommendation, a letter from the agency explaining their decision will be placed in the lease file.

Audit Recommendation:
Obtain information on market lease rates for geographic areas throughout the state and establish procedures for evaluating market rates and including market rate evaluations in lease files.

SPC's Implementation:

- SPC now has access to market data from a nationally recognized source (CoStar) which allows us to compare SPC lease rates to market rates. SPC will perform this function annually at the beginning of the calendar year to prepare for the April, May and June period when most leases are renegotiated to extend the term for another year. This provides the opportunity to lower costs for those that are deemed to have high rental rates. The Asset Manager will provide to the Leasing Division Manager a list of those leases that are 1) above the average SPC lease rate for the particular city of its location, and 2) above the city market rental rate. Those leases will then be targeted for potential renegotiation and supporting documentation will be placed in each lease file.

Audit Recommendation:
Establish working definitions to classify the quality of space occupied by state entities. SPC should also require that state entities provide written justification for leases of "premium" class space and consider requiring formal SPC approval for leases of premium space.

SPC's Implementation:

- SPC's leasing staff will make a recommendation to the agency regarding its determination of the best location, quality of space and the rental rate. If the recommendation is not accepted, the agency will be required to provide written justification.

Audit Recommendation:
Require that lease files include justification when space standards are exceeded by 10% or more.

SPC's Implementation:

- SPC's Transaction Management – Leasing Division has written standard operating procedures that contain a Tolerance Level Table to guide and document space standard (square footage) deviations. Any leases that exceed those standards will require documentation explaining such deviation in the lease files.

Audit Recommendation:
Develop a strategy for performing metro-plans in the future. The strategy should prioritize locations with the greatest potential for cost savings.

SPC's Implementation:

- SPC's is in the process on conducting a metro plan for Decatur and will perform one metro plan annually.

Audit Recommendation:
Establish policies and procedures for conducting periodic, systematic analysis of BLLIP data records to identify areas for potential cost savings.

SPC's Implementation:

- As noted earlier, SPC made a concerted effort to correct missing and inaccurate data in BLLIP. SPC contacted a total of 27 agencies that were identified based on six key fields that were either lacking data or in need of updating one or more of the building key fields. Additionally, SPC met with the eight agencies that represented approximately 90% of the missing data in a focused effort to gather complete information. In all but two agencies (Department of Natural Resources and the Board of Regents), those fields lacking data or in need of updating have been corrected. In addition, SPC reviews the six key fields monthly to ensure data accuracy going forward.

Audit Recommendation:
Develop a strategy for reevaluating lease costs when leases come up for renewal. The strategy should prioritize leases with the greatest potential for cost savings.

SPC's Implementation:

- As noted earlier, SPC Asset Manager will provide to the Leasing Division Manager a list of those leases that are 1) above the average SPC lease rate for the particular city of its location, and 2) above the city market rate. Those leases will then be targeted for potential renegotiation.

Audit Recommendation:
Determine cost savings that might result from executing multi-year lease agreements, including the tenant improvement costs that will be amortized over the term of a multi-year agreement.

SPC's Implementation:

- SPC estimates that the State could save $2.5 million in the first year and up to $66 million over a 10-year period if SPC had the authority to enter into multi-year lease agreements.

III) Audit Recommendations for Improvement

SPC should conduct additional research related to leases that exceed average market rates to identify opportunities for cost savings.

Audit Recommendation:
The leases over $20 per square foot and the leases that exceed average market rates represent possible opportunities for cost savings. Further research is needed to determine which lease agreements have a cost that is above market rates and is not justified in order to provide services for clients. Although the methodologies adopted to conduct these analyses are relatively simple, they should be systematically incorporated into SPC's standard operating procedures to identify the potential for cost savings.

To ensure that the state is not paying higher than necessary lease rates for properties, SPC should periodically collect market rate data for cities and compare those figures to the cost per square foot figures for existing leases. To ensure that higher than average lease costs are reviewed and justified, SPC should establish a policy and procedure for permitting and documenting the decision to execute a lease at rates that are higher than the established market norm. To facilitate this process, SPC should periodically review BLLIP data for material cost outliers and ensure that those leases have been reviewed.

SPC's Implementation:

- As noted earlier, SPC now has access to market data from a nationally recognized source (CoStar) which allows SPC to compare agency lease rates to market rates on a regular basis, and those leases with higher than average rental rates will be targeted for potential renegotiation.

Audit Recommendation:
SPC should ensure that it uses (and documents) multiple bids to constrain TI costs. It should also develop specific policies for handling and documenting above-standard TI costs. Based on better tracking of exceptional TI costs, SPC could identify if significant TI cost savings might result from the ability to use multi-year leases or from self-funding TIs. This information could then be presented to the General Assembly so it could decide if the potential savings justify the financial risks associated with multi-year leases and self-funded improvements to leased property. In addition, separately documenting above-standard TI costs funded by the landlord could facilitate renegotiation of lease costs once improvements have been paid off.

SPC's Implementation:

- SPC noted that the uniqueness of TIs make them difficult to separate from lease rates but that the cost of some non-standard TI's are maintained in lease files. It also noted that multi-year leasing legislation passed the General Assembly and an amendment to the State Constitution will be voted on in the November general election. Finally, SPC noted that self-funded tenant improvements are not an industry best practice. Tenants very rarely directly fund fixed improvements for office space. That is more

of an obligation of the landlord and landlords rarely break-out TI cost from the rental rate. There is little merit to self-funding tenant improvements. In addition, self-funding tenant improvements for state entities may violate the gratuities clause in the State constitution.