ATTACHMENT A

INF11 Tapping Surplus Property Assets

Summary
The state's laws and processes for identifying and selling underused and surplus state properties are ineffective. The state's laws should be amended and its processes streamlined to increase property sales and revenue to the state.

Background
The state's real property holdings are substantial. According to the Statewide Property Inventory maintained by the Department of General Services (DGS), the state owns over 2,000 properties encompassing 2.5 million acres of land and 195 million square feet of buildings. [1]

State process for identifying surplus property
Most state agencies are required by statute to annually review their real property holdings to determine what, if any, are surplus, underutilized, or in excess of foreseeable needs. This information is required to be reported to DGS. [2] There are a number of exceptions to this law, however, including land transferred to the state as a result of unpaid tax debts, land necessary to build or maintain highways, land administered by the State Lands Commission, land which has transferred to the state by operation of law or which has been distributed to the state by court decree in estates of deceased persons, and lands under the jurisdiction of the State Coastal Conservancy. [3] If any of the properties exempt from this law are no longer needed by the state, the properties are identified and sold under separate authority. [4]

Upon receiving a report from an agency that identifies surplus or underutilized property, DGS will notify all other state agencies to determine if there is an alternative state need for the property. If a state need exists, the property is transferred. If there is no state need, DGS compiles these properties into an annual report to the Legislature requesting authorization to sell it or otherwise dispose of it. [5] There is no oversight of each agency's use of its real property or its decisions to retain it. DGS is often mistakenly perceived as having authority over the state's real property. The department, however, actually controls very little of the state's property holdings. Seventy-seven departments other than DGS own facilities. For every structure owned by DGS there are 130 additional structures in the state's inventory and for every acre of land controlled by DGS there are an additional 7,200 acres of state-owned land. [6]

In a 1995 report mandated by the Legislature, DGS independently identified 123 surplus or underused properties controlled by 12 different agencies. The department, however, did not have authority to submit the identified properties to the Legislature for authorization to sell or dispose of them because the properties were not under its jurisdiction. [7] Only the individual agencies had the authority to submit the properties to the Legislature for authorization to sell or dispose of them. Although the 12 agencies have been required by statute to review their property holdings annually for underutilized and surplus properties since 1988, the 123 properties had not been identified as surplus or underused. [8]

Only a few of the 123 properties identified in DGS' 1995 report have subsequently been identified by the individual agencies in their annual surplus property reports and few properties overall have been sold. In 2000, three properties with a total estimated value of $622,000 were identified in reports to DGS as surplus. [9] In 2001, four properties with an estimated value of $20 million were identified. [10] In 2002, and again in 2003, there were no surplus properties identified. [11]

In a 2001 study by the California State Auditor, eight state agencies with large land holdings in 15 designated high-cost counties were questioned to determine whether they annually review their properties to determine if any were surplus or underutilized and if so, whether they had written policies for doing so. The State Lands Commission is exempt from the law requiring review of its holdings and said that it does not review its holdings to determine if any are surplus or underused. Two agencies, the Department of the Military and the Department of Water Resources, said that they do not review their property for potential surplus because they have little or no surplus property. The other five agencies said they perform annual reviews of their property, but none of these agencies had written procedures for evaluating potential surplus or underutilized properties and none could produce any detailed evidence of past reviews. [12]

Examples of underutilized or surplus property

Following is an example highlighting the inadequacies inherent in the state's process for identifying underused state property. Orange County is now California's second most populous county. With three million inhabitants, it is also one of California's most urban counties. The county's growth has created a shortage of affordable housing. According to the California Association of Realtors March 2004 Housing Affordability Index, only 14 percent of Orange County households can afford to purchase a median-priced home. San Francisco is the only one of California's 58 counties that is worse, at 12 percent. [13]

The state owns 190 acres in the City of Costa Mesa, located in Orange County. The land is used to hold the annual Orange County Fair, a summertime agricultural fair. Preliminary discussions with local brokers and appraisers active in the Orange County area indicate that its highest and best use would be for housing. They estimate the property would be worth $27–$30/per square foot, or about $230 million, if it were properly zoned, approved for development, and clear of all hazardous materials and existing improvements. [14] If the land were developed to accommodate four to six single family detached homes per acre, it would allow about 1,000 homes to be built. Higher densities of more than four to six housing units per acre along with other development including retail, apartments and office space, for example, are possible with the cooperation of local government in the zoning and development process. [15]

The Department of Food and Agriculture, which is responsible for this property, has never identified the property as being unused or underused. [16] From the perspective of the Department of Food and Agriculture, the property is being fully used to deliver a state program. It is not underused or surplus. A property's value is rarely considered by state agencies when evaluating a property for consideration as surplus or underused. Only the current and planned future usage of the property is considered. [17]

Another example of the state's underutilization of state-owned property is the state's property in downtown San Diego, where the state owns two full city blocks. On one block is a six story, 174,000 square foot, state office building built in 1962. On the other block is a single story parking garage, a vacant 11,000 square foot building and about 150 surface parking spaces. The state plans to remove all of the existing structures, build a new 315,000 square foot building on one site and a surface parking lot on the other. [18]

Although the state plans to construct only 315,000 square feet, the current zoning on these parcels, however, would allow about 1 million square feet of building area. [19] Development density is an important issue for the City of San Diego. The city's community plan update, which is currently in process, projects the number of downtown residents will quadruple from 18,000 to 75,000 and the current downtown employment population will more than double from 75,000 to 175,000, along with substantial increases in civic and cultural activities. [20] In 2002, San Diego Mayor, Dick Murphy, wrote to then Governor Davis expressing his concerns that the state's plans are not effectively utilizing the property. The City of San Diego encourages maximum density development downtown and the Mayor asked the Governor to ensure that the project achieve the same minimum density requirements of a private developer. [21] The state, however, has not changed its development plans for its downtown properties. [22]

State's process for selling and giving away its property is lengthy

Once a state property is identified as surplus, it takes years to sell it. For the 26 properties sold by DGS in the last 10 years it took from one to 16 years to dispose of the property, with just over half taking seven years or more. On average, property sold by DGS remains on the surplus list for 6.7 years before it is sold. [23] One important factor contributing to the lengthy sales process is the requirement that local governments and nonprofit corporations receive first right of refusal to purchase state surplus property. [24]

One example of the delays resulting from the first right of refusal provision in law is the sale of the surplus Richmond Employment Development Department (EDD) office. In 1997, EDD identified the property as surplus. That same year the City of Richmond expressed interest in acquiring property. The Legislature declared the property surplus in 1998. While exercising its first right of refusal and effectively stopping the state from marketing the property to another buyer, the City began lobbying its congressional representative and state-elected officials to purchase the property at no cost. Three years later in 2001, legislation was passed transferring the property to the City for free. The City is now in the process of obtaining funds to redevelop the property and expects to sell it in the summer of 2004. [25]

Transferring surplus state property for free requires specific legislation, but selling surplus property for less than fair market value is permitted and often occurs. State law allows state property to be sold to local governments and nonprofit entities for less than fair market value if the property is to be used for housing, open space, parks or educational purposes. [26] During Fiscal Year 2001–2002, the most recent year for which sales data are available, three of six properties were, pursuant to legislative authorization, sold for less than fair market value, resulting in about $1.6 million in lost revenue. [27]

The California Department of Transportation (Caltrans) administers a surplus property sales program separate from that of DGS for properties acquired with State Highway Trust Funds that are no longer needed for transportation purposes. [28] Caltrans' surplus properties are required to be offered to other public agencies prior to public sale. [29] Caltrans' surplus property sales program recently sold residential properties located in the cities of Pasadena, South Pasadena, and Los Angeles. The property was designated to be sold for low and moderate income housing, as required by Government Code Section 54235. Adequate low and moderate income housing is an important goal for the state, but the cost of meeting that goal through Caltrans' surplus property sales program is high.

For example, as required by law, Caltrans recently sold 11 surplus properties in Pasadena and South Pasadena to low and moderate income tenants for less than market value. The combined market value of these properties was about $3 million. The properties were sold for a combined total of about $900,000. Each property, therefore, was sold for about $191,000 less than its market value. There are an additional 455 properties still owned by the state in areas that were originally acquired for the 710 freeway project. The project has been delayed indefinitely due to environmental concerns. If the project is officially cancelled, the remaining 455 properties will be sold subject to Government Code Section 54235. In a 2004 legislative proposal, Caltrans estimated that if these properties are sold without a change in law, the state will sell the property for about $143 million below market value. [30]

Promising practices

Despite these restrictions, the state has had some success selling its high-value surplus urban property. In 1998, the National Association of Directors of Administration and General Services awarded DGS Asset Enhancement Program an award of distinction for the innovative sale of three key pieces of the state's surplus real property. These sales created 16,000 new jobs, generated more than $1 billion in new construction and returned more than 360 acres of valuable land to the tax rolls. The properties have also provided affordable housing, a new subsidized day care center, new facilities at an existing state development center, additional transportation infrastructure, historic preservation, numerous public amenities, and wildlife habitat, while still creating remarkable financial returns to the state's taxpayers. [31]

The DGS Asset Enhancement Program demonstrates DGS has the necessary expertise to work effectively with land use consultants and state agencies to determine optimal use of large urban property. It also demonstrates DGS' ability to identify possible surplus property by assisting agencies in consolidating or relocating state operations located on high-valued property.

The DGS Asset Enhancement Program uses an asset enhancement model to evaluate a variety of factors prior to a property being deemed surplus. For example, the model is used to determine a property's highest and best use and its infrastructure capacity. It includes components that take into consideration basic environmental assessments and conceptual land planning in addition to site-specific issues such as historic resources, demolition, traffic and potential restrictions on the land's use. The model also calls for interviewing local officials, addressing community and neighborhood concerns and foreseeable environmental issues. [32]

Inadequate funding and the state's cumbersome and lengthy process for contracting, however, limit the success of DGS' Asset Enhancement Program. The asset enhancement models used by the program are intended to identify state-owned property that could be sold and put to better use. This often requires funding and contracting with consultants prior to a property being identified as surplus. Unfortunately, the state's process for funding projects to sell state property typically begins only after a site has been designated as surplus and the funding must be requested as long as 18 months in advance—at a time when the total amount needed often cannot be accurately estimated. [33]

The effectiveness of DGS' Asset Enhancement Program also is limited by the state contracting process. It is typical for a state contract to take a year or longer to process. This does not adequately meet the needs of the program because the scope of analysis necessary for determining the best use of a property can and does frequently change. For example, toxic materials discovered on a site will expand the scope of environmental analysis required. Conversely, some projects may be cancelled based on changes in market conditions or strong local opposition.

In other instances, the analysis of a property may be completed, but development or selling of the property may be delayed due to lack of funding, market conditions, local opposition, or other factors. If the obstacles are overcome and the project is to continue, the state's contract with its consultants for the project will likely have expired. Due to state contracting requirements, the state must start over again with its process to contract with consultants. This can result in the state contracting with a different consultant, rather than using the consultant who completed the initial analysis of the property. This slows down projects and precludes the state from leveraging the prior consultant's existing knowledge and project-specific expertise, resulting in increased costs to the state. [34]

Recommendations

The following recommendations are consistent with Governor Schwarzenegger's May 11, 2004, Executive Order (S-10-04) directing improvement of the state's real estate asset and property management. Implementation of these recommendations will result in more surplus properties being identified and sold, a faster cycle time from identification to sale, higher sales proceeds for the state, and a more streamlined process.

A. The Governor should work with the Legislature to empower the State and Consumer Services Agency, or its successor, to declare state assets surplus and direct their sale.

B. The Governor should work with the Legislature to amend state law to require the sale of state property at fair market value.

C. The Governor should work with the Legislature to amend state law to eliminate the right of first refusal for surplus property to any non-state agency.

D. **The State and Consumer Services Agency, or its successor, should be appropriated continuous funding to evaluate and sell surplus property.**

E. **The State and Consumer Services Agency, or its successor, should be permitted to enter master service contracts for consulting services required to study and sell surplus property.**

Fiscal Impact

The state owns over 2.5 million acres of land and 195 million square feet of buildings. [35] Previous reviews of the state's holdings have identified numerous potentially surplus and underutilized properties that have not yet been sold. The combined value of these surplus and underutilized properties is estimated to be in the high hundreds of millions of dollars.

The May Revision to the FY 2004–2005 budget includes $50 million in increased revenue from surplus property sales and $2.8 million in funding from the Property Acquisition Law account to pay for added staff and consulting costs to achieve these sales. [36] Depending on which properties are eventually selected for sale, and restrictions in statute on the use of the proceeds resulting from disposal, the proceeds will be applied to either General Fund or special fund revenue. In the initial years of the implementation of these recommendations, the assumption is that efforts will be made to target properties that will have a direct impact on the General Fund.

Staff and consulting costs have historically averaged about 5 percent of surplus sales proceeds. Therefore, based on an annual funding level of about $2.5 million, an estimated $50 million in annual property sales could be generated. Assuming that the recommendations contained in this paper are implemented, doubling the funding for staff and consulting costs to $5 million annually could result in $100 million in annual property sales.

Immediate sales are expected, but because of the complexity of most of these sales transactions, it is anticipated that greater sales proceeds will be achieved in years three through five. Most of the state's underutilized and surplus properties are now used to deliver state programs. Unless these state programs are discontinued, relocation will be necessary. In the few instances where relocation is unnecessary and there is little increased property value to be gained by securing development entitlements prior to disposal, the sales could be completed in one to two years. In other more complex sales requiring both program relocation and the state to secure the development entitlements, sales could take three to five years.

General Fund
(dollars in thousands)

Fiscal Year	Sales Proceeds	Costs	Net Savings (Costs)	Change in PYs
2004–05	$50,000	$2,800	$47,200	4
2005–06	$50,000	$2,800	$47,200	4

2006–07	$100,000	$5,000	$95,000	4
2007–08	$100,000	$5,000	$95,000	4
2008–09	$100,000	$5,000	$95,000	4

Note: The dollars and PYs for each year in the above chart reflect the total change for that year from 2003–04 expenditures, revenues and PYs.

Endnotes

[1] Department of General Services. "Statewide Property Inventory." (last visited June 21, 2004).
[2] California Government Code Sections 11011–11011.20.
[3] California Government Code Sections 11011–11011.20.
[4] Interview with Dwight Weathers, chief of Real Estate Services Section, Professional Services Branch, Department of General Services, Sacramento, California, June 18, 2004.
[5] California Government Code Sections 11011–11011.20, 14667.1, and 14673.
[6] Commission on California State Government Organization and Economy, "California Real Property Management, A Cornerstone for Structural Reform" (Sacramento, California, December 1995), p. 15.
[7] State and Consumer Services Agency and Department of General Services, "State and Consumer Services Agency, Department of General Services, Office of Real Estate and Design Services, Report to the Legislature: State Surplus Property Inventory" (Sacramento, California, January 1995), Exhibit D, pp. 1–3, and Exhibit E, pp. 1–2.
[8] California State Auditor, "The State's Real Property Assets: The State Has Identified Surplus Real Property, but Some of Its Property Management Processes are Ineffective" (Sacramento, California, January 2001), p. 3.
[9] Department of General Services, "Annual Report to the State Legislature, Surplus Proprietary Lands 2000" (Sacramento, California, August 25, 2000), p. 1.
[10] Department of General Services, "Annual Report to the State Legislature, Surplus Proprietary Lands 2001" (Sacramento, California, January 1, 2001), p. 1.
[11] Department of General Services, "Annual Report to the State Legislature, Surplus Proprietary Lands 2002" (Sacramento, California, January 1, 2002), p. 1; and Department of General Services, "Annual Report to the State Legislature, Surplus Proprietary Lands 2003" (Sacramento, California, October 30, 2003), p. 1.
[12] California State Auditor, "The State's Real Property Assets: The State has Identified Surplus Real Property but Some of Its Property Management Processes are Ineffective," pp. 35–37.
[13] California Association of Realtors, (May 6, 2004), "California's Housing Affordability Index falls seven points in March; minimum household income needed to purchase median-priced home just under $100,000" (last visited May 25, 2004).
[14] Interview with Bill Bacon, first vice president, CB Richard Ellis, Sacramento, California, June 17, 2004.
[15] Interview with John Brooks, acting deputy director, Real Estate Services Division, Department of General Services, Sacramento, California, June 18, 2004.
[16] Interview with Dwight Weathers, chief of Real Estate Services Section, Professional Services Branch, Department of General Services, Sacramento, California, June 18, 2004.
[17] Interview with Dwight Weathers.
[18] California Government Code Section 14669.15.
[19] San Diego Municipal Code for the Centre City Planned District, Section 103.1925. This code section describes Land Use A = Commercial/Office District (allows Residential too), Existing Floor Area Ratios (FAR) = 8, the Eastern most block has a potential increase to FAR 10, if 80% Residential, the potential FAR for both blocks may be increased to 18 under the Community Plan Update currently being considered (June 18, 2004).
[20] Centre City Design Corporation, (October 2003). "San Diego Downtown Community Plan Update" (last visited May 25, 2004), p. 12.
[21] Letter from Dick Murphy, mayor, City of San Diego, to California Governor, Gray Davis, September 16, 2002.
[22] California Government Code Section 14669.16.
[23] California State Auditor, "The State's Real Property Assets: The State Has Identified Surplus Real Property, but Some of Its Property Management Processes are Ineffective," p. 21.
[24] California State Auditor "The State's Real Property Assets: The State Has Identified Surplus Real Property but Some of Its Property Management Processes are Ineffective," p. 22.
[25] Interview with Dwight Weathers, March 25, 2004.

[26] California Government Code Sections 11011–11011.20 and 54235–54238.7.
[27] Department of General Services, "Annual Report to the State Legislature, Surplus Proprietary Lands 2003," pp. 5–8.
[28] California Government Code Section 54222; and Streets and H. C. Section 118.6.
[29] California Government Code Section 54222; and Streets and H. C. Section 118.6.
[30] California Department of Transportation, "2004 Legislative Proposal for Affordable Housing for Low and Moderate Income Tenants," (Sacramento, California, July 16, 2003); and interview with Barry Cowan, chief, Caltrans Office of Real Property Services Division of Right of Way and Land Surveys, Sacramento, California, May 25, 2004.
[31] Department of General Services, "California's Asset Enhancement Approach to Land Sales" by John H. Brooks, chief, Asset Planning and Enhancement Branch, Department of General Services, J. Frank Davidson, assistant chief, Asset Planning and Enhancement Branch, Department of General Services, Paula P. Gutierres, asset manager, Asset Planning and Enhancement Branch, Department of General Services, Claude Gruen, principal economist, Gruen Gruen + Associates, San Francisco, California, Nina Gruen, principal sociologist, Gruen Gruen + Associates, San Francisco, California, Dan Potash, attorney, DVP Associates, Oakland, California (Sacramento, California), p. 1.
[32] Department of General Services, "California's Asset Enhancement Approach to Land Sales," by John H. Brooks, chief, Asset Planning and Enhancement Branch, Department of General Services, J. Frank Davidson, assistant chief, Asset Planning and Enhancement Branch, Department of General Services, Paula P. Gutierres, asset manager, Asset Planning and Enhancement Branch, Department of General Services, Claude Gruen, principal economist, Gruen Gruen + Associates, San Francisco, California, Nina Gruen, principal sociologist, Gruen Gruen + Associates, San Francisco, California, Dan Potash, attorney, DVP Associates, Oakland, California, p. 1.
[33] Interview with John Brooks.
[34] Interview with Paula Gutierres, supervising real estate officer, Asset Planning and Enhancement Branch, Real Estate Services Division, Department of General Services, Sacramento, California, June 21, 2004; and California Government Code Sections 19130–19134.
[35] Department of General Services, "Statewide Property Inventory," (last visited June 21, 2004).
[36] Department of Finance, "Governor's Budget May Revision 2004–05" (Sacramento, California, May 2004), pp. 88–89.