

**REPORT OF THE
SECRETARY OF ADMINISTRATION**

Progress Report: Real Estate Services

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



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**COMMONWEALTH OF VIRGINIA
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COMMONWEALTH of VIRGINIA

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MEMORANDUM

TO: The Honorable Vincent F. Callahan, Jr., Chair, House Appropriations Committee

THROUGH: The Honorable Viola O. Baskerville, Secretary of Administration *Viola O. Baskerville*

FROM: Richard F. Sliwoski, P.E., Director *Richard F. Sliwoski*

SUBJECT: Progress Report of Real Estate Services
As Required by Item 71 of
Ch. 3, 2006 Acts of Assembly, Special Session 1

Item 71 of Ch. 3, 2006 Acts of Assembly, Special Session 1, provides in part:

1. This appropriation includes an internal service fund to support a program of Real Estate Services. This internal service fund may include rent payments or fees to be paid by state agencies and institutions for their occupancy of facilities and for the agency's management of real property transactions, including, but not necessarily limited to, leases of non-state owned office space throughout the Commonwealth for use by such agencies and institutions. Also included are funds to pay costs associated with the disposal of state-owned real property and interests therein. The costs paid for each sale shall be returned to the fund upon sale of the property, in an amount calculated at 115 percent of such costs. The estimated cost for this service area is \$950,000 the first year and \$950,000 the second year. In implementing the program, the department may utilize brokerage services, portfolio management strategies, personnel policies, and compensation practices generally consistent with prevailing industry best practices.

2. The department shall report its progress in implementing this program to the Governor and the chairmen of the Senate Finance and House Appropriations Committees by November 1, 2006.

DRES' role as "real estate service provider" to the agencies and institutions of the Commonwealth is dependent on development of a sustainable funding source. One option is development of an internal service fund that will fully support the Division's ongoing operations. Another option is full general fund support, and a third option is a combination of both general fund and internal service fund. In any case, the funding must consider the broad range of services provided by DRES and the support provided by DGS (such as administration of lease payments by our fiscal office).

The model we are currently pursuing is an expansion of an existing internal service fund that has been in place for several years to support sale of surplus real property. To that end, we have been engaged in evaluating mechanisms to create and maintain the fund. Consideration has been given to: adding a percentage charge to rental paid for privately owned facilities leased by DGS on behalf of agencies; requiring payment of a service charge when processing utility easements; charging percentage fees for acquisitions and sales; and, charging fees based solely on time invested by DRES on the various real estate transactions we handle.

Initial outlines of proposed billing models and revenue formulas are under review within the Department of General Services. It is anticipated that the appropriate internal service fund model will be presented to The Joint Legislative Audit and Review Commission early in 2007.

Program Status

BACKGROUND

In 2002, the Governor's Commission on Efficiency and Effectiveness recommended that the Commonwealth undertake better management of real property. Subsequently, the Department of General Services, through a competitive solicitation, engaged the consulting services of industry experts to provide advice on prevailing real estate trends and best practices. The Governor then issued Executive Order 75 (2004), which called for the establishment of a comprehensive portfolio management program, including both leased and owned facilities. The four primary areas of this initiative include: developing a portfolio management strategy, restructuring the organization, redesigning the business processes, and creation of an MIS strategy.

The following values form the foundation of this new portfolio management program:

- Customer service
- Collaboration, facilitation and joint problem-solving
- Performance standards and measures
- Cost savings and efficiencies

A comprehensive portfolio management program for real estate will generate many improvements, including economies of scale and market leverage in leasing and

contracts, fewer redundant support areas, better space utilization, more productive use of staff, more consistent and higher quality facilities, and better environments for teamwork, communication and collaboration. Additional benefits include better citizen access, more real estate expertise incorporated into operations, greater flexibility to respond to business changes, enhanced collaboration among agency programs, and a more efficient and less confusing process for private landlords and owners.

To implement this initiative, an organizational restructuring was undertaken by the Department of General Services in January of 2005, creating the Division of Real Estate Services (DRES). DRES completed the first phase of its organization ramp-up in 2005 and early 2006. DRES' staff is also supported by third party service providers for real estate transactional/brokerage services and space planning/architectural services.

ACTIVITIES THROUGH NOVEMBER 2006

DRES has most recently made internal changes in order to better leverage staff resources, and we have instituted a plan for better communications with the client agencies. These changes are designed to foster much better understandings of client needs and evolve a more comprehensive and integrated program.

The establishment of an integrated real estate portfolio management program for real property has been designed and is being further refined to be customer-oriented and business-based to include strategic planning, transaction management, space management, project management for construction and tenant fit-up services, and ongoing administration of the leases entered. The new program takes an enterprise-wide perspective, but it does not encompass the entirety of the state's real estate holdings. Specialized facilities such as prisons, mental hospitals, campuses of institutions of higher education and off-campus facilities devoted solely to academic uses, and retail-oriented programs such as the ABC stores and DMV service centers are not within the initial scope of the portfolio initiative. Given our limited resources, we believe opportunities for more immediate and productive leverage is greater elsewhere.

The focus for DRES is concentrated on leased office space. The consultant's study estimated the net present value of potential savings that could be achieved through better portfolio management at \$68 million over a ten year period. Real estate purchases and other acquisitions will continue to be evaluated by DRES, and we continue to market and sell surplus property as it is identified and becomes available.

The real estate portfolio management initiative is a multi-year project that continues to extend its reach into the various agencies as individual real estate service needs evolve, and existing leases expire, resulting in opportunities to develop and pursue new portfolio management strategies. While the initial roll out has the usual upfront investments and challenges of a new and innovative program, tangible benefits continue to be realized as further described below, and the anticipated long-term benefits continue to be validated through short-term progress.

Through November 15, 2006, active portfolio management of leased office space needs statewide, including initiating competitive lease negotiations utilizing tenant brokerage services, implementation of reduced office space standards, and improved leveraging of owned real estate, has resulted in gross cost savings of approximately \$20.628 million on lease transactions with a total contract value of \$114.058 million and representing over 900,000 square feet of space. These savings will be realized over the entire terms of the various leases, averaging some \$3.170 million annually.

DRES also continues to maximize proceeds on sales of surplus properties as they are identified and since November 2005, ten transactions have been completed generating total proceeds of approximately \$9.772 million. Several other sales are currently in process.

Since real estate administration and supporting information historically have been widely dispersed across state agencies, an accurate consolidated real estate database remains a necessary component to support the portfolio management program and the related analyses and strategic planning. To achieve accuracy in the current system, all agencies and institutions that lease or own office space have been surveyed. While progress has been made over the last year to provide for data validation, certain historical data continues to require ongoing additional verification and refinement, and it has been determined that technology replacements will be required to support the full realization of savings and efficiency within the real estate program.

The current automated real estate information system, PLATS, was upgraded in 2006 to the current release as a short-term solution to ensuring a stable database. In addition, a scanning project was completed in 2006 providing for the integration of electronic lease images into the PLATS system to allow for more efficient access. However, despite customization of the PLATS system over the years to meet the Commonwealth's then defined needs, the functionality provided by PLATS is severely limited compared to Integrated Workplace Management Systems (IWMS) currently on the market. In addition, the developer and owner of PLATS is no longer supporting previous customizations needed by DRES. Therefore, replacement of PLATS with an Integrated Workplace Management Systems (IWMS) is being pursued as a major DRES strategic goal during 2006 - 2007.

The project proposal to replace PLATS with a new system was approved by the Commonwealth's Chief Information Officer on November 16, 2006 and DRES anticipates release of a Request for Proposals by the end of the year. Implementation of a new IWMS system and replacement of PLATS will provide for a more coordinated approach to the management of the Commonwealth's real estate assets by providing modernized and automated business solutions and easy data access and reporting capabilities necessary for effective and efficient real estate portfolio management in a high volume environment.

ACHIEVEMENTS

Implementation of the real estate initiative continues, and will include further refinement, including development of a body of specific performance standards. However, the programs has already resulted in several significant achievements:

- **PORTFOLIO MANAGEMENT:** A principal objective of the current initiative is to manage real estate as a single enterprise. By consolidating overall portfolio management within DRES, savings continue to be achieved through better leveraging owned and leased real estate. DRES has been able to match “excess supply” of space to “new demand” on several occasions by arranging for agencies to transfer existing underutilized space to other agencies in lieu of leasing new space to meet new demands. In one situation alone, savings totaling \$1.608 million over four and one half years was achieved when DRES arranged for one agency with excess space to make it available to another agency that had a new space need. As another example of enterprise wide management, DRES was able to facilitate locating several Department of Veterans Services personnel into existing Virginia Employment Commission offices, resulting in both programmatic synergies and cost savings.
- **IMPROVED LEASE TERMS:** As existing leases expire, DRES actively conducts market analyses to identify opportunities for better and more flexible lease terms, using expert tenant brokers to represent the Commonwealth’s interests. Pro-active negotiations with landlords have resulted in more favorable lease terms, including cost savings in lease payments and ensuring that landlord contributions to tenant improvements meet agency needs and are in line with market expectations. Competitive lease renewal processes initiated by DRES have resulted in “incumbent landlords” becoming more aggressive in their attempt maintain the Commonwealth as a tenant. In one completed transaction in 2006, DRES took over “agency led” negotiations and by exploring other viable alternatives in the market, was able to negotiate an improvement to the economic terms that were already previously agreed to by both the landlord and the agency tenant. Through DRES’s actions, the agency will now save some \$350,800 over the new seven year lease renewal.
- **SPACE STANDARDS:** In August 2006, DGS formally published the new office space policy of 210 usable square feet per employee, which is reduced from the previous standard of 250 usable square feet per person. Since the publication of the 210 standard, the Commonwealth has reevaluated this benchmark and determined that a 205 usable square feet per employee is more in line with current trends. Therefore, DRES has set 205 square feet per employee as the

new benchmark to be achieved. The space standard has been and continues to be actively implemented for new space requests as well as in “reconfiguration” studies on existing space. In one situation alone in 2006, implementation of the new space standards for a “build-to-suit” location resulted in a 13% reduction in building size that will save approximately \$415,000 over the new ten-year lease term.

- **CO-LOCATIONS AND MASTER LEASES:** Opportunities for co-locating state agencies continue to be actively pursued both in the major and tertiary markets of the state. In addition, multi-agency “master lease agreements” have been completed in Richmond, Norfolk and Virginia Beach where *ad hoc* co-locations of various state agencies in the same office parks existed, but the Commonwealth’s full market leverage was not previously exerted. These three master lease transactions alone will result in gross cost savings totaling over \$5.237 million on over 200,000 sf of leased office space during the ten-year lease terms. Similar evaluations of “master” lease opportunities to fully capture the Commonwealth’s bargaining power are in process in other markets of the state.
- **STRATEGIC PLANNING:** Information on the current cost and utilization of owned and leased office facilities continues to be collected. With this information, including current staffing levels, DRES is able to apply the new space standards to determine where excess space may exist, determine where rental rates appear to exceed current market rates and then focus strategic planning efforts on those situations with most opportunity for savings. In one recent situation, a re-evaluation of space needs and the lease rate being paid by the agency relative to current market rents resulted in issuance of a Request For Proposal to seek new space alternatives that ultimately will result in relocation of an agency to a new facility at a 23% reduction in annual rental, producing gross savings of \$406,600 over a new seven-year lease term.
- **FIT-UP STANDARDS:** New standards have been developed for interior fixtures, finishes and equipment that will provide effective and productive facilities at reasonable cost. Ongoing review and negotiation of tenant improvement cost estimates and market tenant improvement allowances continue to result in tangible cost savings and landlord funded space upgrades for many of DRES’s customers.

CONCLUSION

The goal of all of these efforts is to take maximum advantage of the Commonwealth's considerable buying power across the entire enterprise to providing lower costs and promote greater flexibility in managing the Commonwealth's vast portfolio of real estate assets. Progress over the last year validates that the savings and efficiencies envisioned by the Governor's Commission on Efficiency and Effectiveness in 2002 are real. The actions set forth above, and those under future development as part of the this initiative will continue to make a significant difference in the cost and quality of the broad range of facilities needed by Virginia's agencies and institutions to carry-out their public missions at the best possible value to taxpayers.

We will be pleased to discuss these issues with you, or to provide any additional information that may be needed.

cc: The Honorable William H. Leighty
Chief of Staff