

LAC

Report to General Assembly

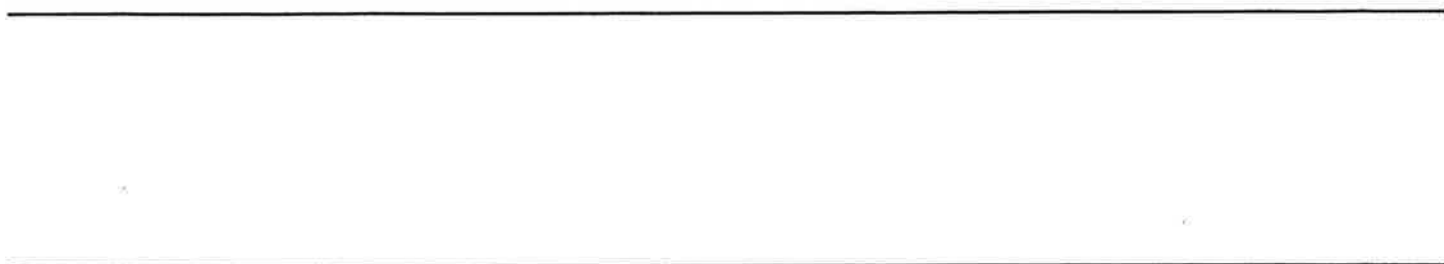
March 1989

State Leasing Policies



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State Leasing Policies

In September 1988, the Audit Council received a request to investigate state leasing practices which presented questions in ten areas. As a preliminary response, this report outlines the Budget and Control Board's general leasing policies and procedures presently in force, and also, highlights existing and proposed regulations and legislation.

Scope and Methodology

This report does not report results of an investigation, or an audit, of state leasing practices. Rather, this is an informational response based on (1) review of statutes and regulations currently in force, (2) review of regulations proposed by the Budget and Control Board's Division of General Services, (3) review of proposed legislation, and (4) interviews with General Services officials and materials supplied by these officials. This report is organized by the ten areas of inquiry presented in the legislative request.

1. Lease Origination

The law indicates that agencies initiate the search for new space to be leased. Neither the statutes nor the regulations pertaining to leasing address whether developers can originate the lease process.

Statutory Requirements

According to §11-35-1590 of the South Carolina Code of Laws, when any governmental body decides it needs to rent real property and no state-owned property is available, it shall notify General Services of its needs. General Services is responsible for determining whether state-owned property is available. The law requires General Services to use rental request forms which ask for such information as the amount and location of space desired, the purpose for which it shall be used, and the proposed date of occupancy.

According to §11-35-1590, upon receipt of the request, General Services investigates available rental space which would meet the agency's needs, including specific locations preferred by the agency. When the agency and General Services find and agree upon suitable space which also meets the necessary requirements and standards for state leasing as prescribed in Budget and Control Board regulations, General Services shall give its written approval for the agency to sign the lease agreement.

The law also designates the Budget and Control Board as the single central broker for the leasing of real property for state agencies. This section states that all agencies are required to follow the leasing provisions of this section; however, Board regulations give partial exemptions to seven agencies from this requirement (see below).

Regulation

Regulation 19-445.2120 states that no agency may rent real property not owned by the state without the approval of General Services, with the exception of the following:

- *Highway Department*--lands leased for maintenance and construction purposes;
- *Mental Health*--community mental health centers;
- *Corrections*--farm lands;
- *Mental Retardation*--farm lands;
- *Forestry*--forest lands;
- *Parks, Recreation and Tourism*--state parks and recreation lands; and
- *Wildlife and Marine Resources*--game management areas.

However, the seven agencies are required to file annual reports with General Services containing copies of all existing leases of state-owned and nonstate-owned real property. General Services has the authority to grant, limit or withdraw any exemption.

The Budget and Control Board has also exempted the Research Authority and State Housing Authority from the leasing requirements, and all:

- Parking spaces in state-owned garages or lots;
- State-owned lecture halls, theatres, coliseums, athletic areas, recreation areas and other areas for periods of less than seven days;
- State-owned box seats or other seats;
- State-owned farmers' markets;
- All nonstate-owned real property leased for less than three months in a single fiscal year or for a total cost of less than \$5,000 in a single fiscal year; and
- State-owned student housing and dorm space.

Proviso 16.69 of the FY 88-89 Appropriation Act requires the Budget and Control Board to develop more detailed leasing regulations to be approved by the General Assembly. According to this Proviso, these should include procedures for:

1. Assessing and evaluating agency needs, including the authority to require agency justification for any lease request;
2. Establishing standards for the quality and quantity of space to be leased;
3. Devising and requiring the use of a standard lease form, as approved by the Attorney General, which protects the state's rights including a right of cancellation in the event of:
 - a. non-appropriation of the renting agency;
 - b. dissolution of the agency;
 - c. availability of public space in substitution of private space;
4. Rejecting an agency's request for additional space at a specific location;

5. Directing agencies to be located in public space when available, before private space can be leased;
6. Requiring agencies to submit multi-year financial plans to the Board's budget office before any lease can be signed; and
7. Requiring Joint Bond Review Committee review and Budget and Control Board approval before adopting any lease that commits more than \$1 million in a five-year period.

According to General Services officials, the requirements of Proviso 16.69 are addressed in their proposed regulations and legislation proposed by Senator McConnell.

2. Leasing and Competitive Bidding

Section 11-35-1510 exempts state agencies from competitively bidding leases for real property. Section 11-35-1590(3) requires the Budget and Control Board to promulgate regulations for competitive bidding where feasible. However, none of the regulations address competitive bidding of leases. *In early 1989, the Division of General Services will submit proposed regulations pertaining to competitive bidding of leases to the Budget and Control Board.*

3. Cost Factors in Lease Decisions

According to the Division of General Services Property Management leasing procedures, cost is one factor of several taken into consideration in reaching lease decisions. When the review process is complete, the space most "appropriate in terms of agency needs for location, price and special requirements is selected." A consultant's 1986 report on state agency office space listed the four most prominently mentioned reasons for rental site selection, as parking, location, suitability of space, and price.

However, information given to the Governor's Task Force on Leasing, a citizens committee appointed by Governor Campbell

in fall 1988, mentions recent procedural changes by Property Management that include more detailed analysis of lease proposals, comparing appropriate criteria including total cost and location factors. Proposed General Services regulations state the Division will recommend the lease offering the "most cost effective terms and conditions" after satisfying objective criteria such as parking, location, and special needs. *Of the evaluation criteria included in the proposed regulations, "Total cost shall be given the highest weight of any single factor."*

"Total cost" is defined in the proposed regulations as "including rental payments, upfitting costs, escalations, additional rents, operating and all other costs." While moving costs are not mentioned specifically, they could be considered a part of "all other costs."

The proposed regulations require that for major leases (\$1 million or more in a five-year period) General Services will develop written analyses comparing projected total costs for alternatives under consideration.

4. Evaluation of Agency's Decision to Move

General Services' leasing procedures state that the Division is to become familiar with the agency's "reasons for wanting and/or needing to relocate or for additional space." *However, there is no formal evaluation of whether a move is necessary. The Division has no authority to deny an agency's request to move.*

Proviso 16.69 of the FY 88-89 Appropriation Act requires the Budget and Control Board to promulgate regulations that include procedures for assessing and evaluating agency needs, including authority to require agency justification for a lease request. Further, the regulations are to include procedures for rejecting an agency's request for additional space and/or space at a specific location.

General Services' proposed regulations require agency justification, certified by the Director, for the amount and type of space needed. *The proposed regulations also provide that the "Division of General Services may reject the agency's request for additional space and/or space at a specific location."*

5. Space Allocation Criteria

The "Request for Space" form used by Property Management for agency lease requests includes guidelines for space per square foot, according to employee classification (management - 250 square feet, professional - 160 square feet, and clerical - 110 square feet). However, these allocations are suggested guidelines, not requirements. The Division has no authority to deny agency lease requests.

Proviso 16.69 of the FY 88-89 Appropriation Act directs the Budget and Control Board to promulgate regulations that include standards for the quality and *quantity* of space to be leased by a requesting agency. General Services' proposed regulations state, "The amount of office space desired shall be computed and justified using the standards specified in Section 11-35-1590." Although §11-35-1590 does not specify space allocation standards, according to General Services officials, proposed amendments include such standards.

6. Upfitting Costs

Upfitting costs, or costs for the "finishing work done to complete interior office space including, but not limited to, acoustical ceiling, carpeting, painting, interior walls, lighting, etc . . . , " are not specifically mentioned in lease law, regulations, or policy.

However, the required state standard leases do take account of these costs as "renovations" and "improvements." The standard lease agreements provide for the inclusion of terms for all renovations, including upfitting, to be completed by the landlord before the lease takes effect. No requirements are specified for the type of renovations allowed.

The standard leases also state the tenant may make nonstructural additions, improvements, or alterations to the property at the tenant's expense. The standard leases give the tenant the right to remove improvements at termination of the lease with the responsibility for restoring the property to its prior condition.

General Services' proposed regulations specifically include upfitting costs as a part of the "total costs" that are primary evaluation criteria. Also, before approving a lease agreement, General Services is to verify that "upfitting costs represent current market costs."

7. Conflicts of Interest

There are no sections of state leasing law concerning conflicts of interest, or, in particular, those between agency board members and developers or their attorneys. The Code's ethics section also does not directly address conflicts of interest between agency board members and developers or their attorneys. However, Section 8, Chapter 13 of the South Carolina Code of Laws contains the state ethics legislation for public employees and officials, which is applicable to leasing situations.

Section 8-13-410 prohibits the use of public positions for private gain. It states that no public official or employee shall participate directly or indirectly in a procurement when he has knowledge or notice that:

(a) he or any business with which he is associated has a financial interest pertaining to the procurement;

(b) any other person, business, or organization with whom he or a member of his household is negotiating or has an arrangement concerning prospective employment is involved in the procurement.

Section 8-13-420 provides for sanctions against those who give or offer compensation to influence the actions of a public employee or official. This compensation includes the promise of future employment. Also, if any public official or employee solicits or accepts such compensation, he will be subject to the punishment described in §16-9-210 and 220, which includes forfeiting his position, and either imprisonment at hard labor or a fine not exceeding \$5,000.

Section 8-13-430 prohibits any official or employee from receiving additional compensation for advice or assistance given in his official capacity. Section 8-13-460 details disclosure requirements for public officials and employees to follow when there is a

potential conflict of interest. Also, §8-13-810 requires public officials and specified public employees, before beginning employment, to file statements of economic interest, which are public records. The statements include all offices, directorships, and fiduciary relationships, as well as a description of all real estate in which a person, or member of his household, has a direct or indirect interest.

Section 8-13-500 describes three situations which are breaches of ethical standards. The first is when a public employee or official participating directly in the procurement process resigns and accepts employment with a person contracting with the governmental body with whom the employee was formerly associated. The second and third prohibit former and present public employees from being used as, or acting as, agents in regard to matters in which the employee participated personally or is responsible.

8. Use of Vacant State-Owned Space

Neither lease law, regulations nor policies mention *planning* for the use of state-owned space vacated by an agency. *However, according to General Services officials, the Division's policy is to constantly plan for the optimal utilization of all state-owned space.* Also, the desirable price and location of state-owned space ensure that vacancies will be filled. General Services' leasing policies require state agencies to use state-owned or currently leased space if available and appropriate.

Proviso 16.69 of the FY 88-89 Appropriation Act requires the Budget and Control Board to promulgate regulations to include procedures for directing agencies to be located in public space, when available, before private space can be leased. Also, the Board is to use a standard lease asserting the state's prerogative to cancel in the event of availability of public space in substitution for private space being leased.

General Services' proposed regulations include provisions as required by the proviso. Also, the required standard state leases allow the tenant to cancel a private lease after the first 6 months of the basic term, by giving 120 days written notice, for the

purpose of relocating to a building owned or otherwise controlled by the state.

9. Real Property Acquisition Methods

No comprehensive law or formal policy exists to address the comparative advantages and disadvantages of the different types of property/office space acquisition. An individual agency's decision to acquire space, for example, by lease-purchase, as opposed to the lease of privately-owned real estate, is not governed by a formal evaluative process.

Each method of acquiring property follows different procedures. For example, state law, regulations and policy govern the approval of leases of privately-owned real estate (termed "true leases"), as discussed previously. Decisions to acquire state-owned property are made by the General Assembly, by appropriating funds or by authorizing bond funds. However, there are no laws or regulations that govern the approval of lease-purchase agreements. In practice, according to a Budget and Control Board official, these decisions have been made jointly by the Board and the Joint Bond Review Committee.

The need for formal procedures that compare real property acquisition methods to determine which is most beneficial to the state was considered in a 1987 Budget and Control Board/Joint Bond Review Committee study. Among the recommendations made in this study was that a standard decision process be established in permanent law on the state's use of true lease agreements and lease-purchase agreements.

10. Rental Account

Proviso 129.17 of the FY 88-89 Appropriation Act directs the Budget and Control Board to assess and collect rental charges from all state agencies occupying state office buildings. The amount charged each agency must be calculated on a square foot, or other equitable basis of measurement. The total amount collected should be sufficient to cover costs of certain capital

improvement obligations and maintenance and operation costs of state-controlled buildings in Columbia. Rental collections are deposited in the State Treasury. They must be expended only for payment of principal and interest on the capital improvement obligations specified previously, or maintenance and operation costs of state-controlled buildings.

Budget and Control Board officials stated that the per-square-foot rental rates were established in 1975 by a panel of nonstate specialists, including realtors. The rates were comparable to those charged by the private sector. However, it was believed that this was more than the state should have to pay; therefore, the General Services Director reduced them across the board. According to Budget and Control Board officials, these base rates have been uniformly adjusted upward every two to three years based on increases in maintenance and operating expenses. The General Assembly approved all rate increases before they were implemented.

Like the original rental rates, current rates reflect differences in the type of structure. For example, there are different rates for warehouses and offices. Also, rates for office buildings vary depending on the quality of the building.

"Loans"

General Services officials state that there are no procedures used for loans from the rental account because General Services "does not contemplate making advances to other entities which could be called 'loans.'" Furthermore, the officials state that:

In recent years the activity in this regard has mainly been certain transfers to a specific account within the Budget and Control Board when it lacked budgetary funds to enable it to satisfy its responsibilities.

In the two cases where this was done, the transactions were approved by the Budget and Control Board and the Joint Bond Review Committee. Officials believe these cases to be unusual occurrences and do not anticipate it becoming a standard practice; therefore, there are no procedures to address the "loaning" of funds from the rental account.

Appendices

Division of General Services' Proposed Regulations

LEASING REGULATIONS

REGULATIONS TO IMPLEMENT THE PROVISIONS OF SECTION 11-35-1590 SC CODE OF LAWS Prepared by the Office of Property Management

In accordance with Section 11-35-1590 of the SC Code of Laws and Section 16.69 of the 1988-89 Appropriations Act, the following regulations are promulgated.

A. GENERAL REGULATIONS

(1) The Division of General Services shall be accountable for the procurement of leased real property for governmental bodies in accordance with the regulations promulgated by the board.

(2) All leases shall require the written approval of the Division of General Services, except when such lease is exempt from approval as provided in Regulation 19-445.2120 Subsection C or otherwise exempted by the Budget and Control Board.

(3) Before approving any lease, Division of General Services shall:

- (a) assure that all appropriate approvals have been obtained.
 - (b) verify that adequate funds exist for the lease payments;
 - (c) verify that lease payments represent no more than fair market rental;
 - (d) verify that upfitting costs represent no more than current market costs;
 - (e) verify that a multi-year financial plan has been submitted by the requesting agency for review by the Budget and Control Board's budget office.
- (4) All requests for leased real property by governmental bodies and agencies shall be submitted to the Division of General Services on a "Request for Space Form" provided by the Division.

(a) This form shall include, but not be limited to:

- 1. The purpose for which the space will be used.
- 2. Any special requirements or needs with written justification (computer rooms, etc.).
- 3. Parking requirements and justification.
- 4. The general location or area desired.
- 5. A multi-year financial plan for review by the Board's budget office.

- (b) The amount of office space desired shall be computed and justified using the standards specified in Section 11-35-1590.
- (c) Other types of space (warehouse, laboratory, etc.) shall require a written letter of justification from the requesting agency or governmental body and shall include documentation of market standards for use of this type space. The Division of General Services shall be accountable for investigating the existing space or any other information given in the justification.
- (d) The "Request for Space Form" or any other document requesting space or justifying the need for space shall be certified by the Director of the requesting agency or governmental body.
- (5) An agency or governmental body desiring to renew an existing lease is responsible for notifying the Office of Property Management in writing of its intention to do so at least 60 days before the renewal deadline as stated in the lease. Upon approval by appropriate boards and the Division of General Services, the governmental body or agency shall notify the Lessor that it has elected to exercise its right of renewal pursuant to the lease. The Division of General Services may send each a renewal request form and a reminder notice well in advance of these deadlines.
- (6) Under no circumstances will the requesting governmental body or state agency contact or negotiate lease terms with any real estate agency, broker, builder, owner, or representative in reference to space needs without the prior written consent of the Division of General Services.
- (7) The Division of General Services will begin investigation of available rental space within ten (10) working days after receiving the "Request for Space Form".
- (8) When processing requests for space, the Division of General Services will first determine whether appropriate state-owned or state-leased space is available before exploring commercial space alternatives. If such space is available, the Division of General Services will direct the requesting agency or governmental body to occupy said space. If state-owned or state-leased space is unavailable or inappropriate, the Division of General Services shall begin a formal solicitation process to secure proposals for commercial space from as many qualified developers and/or brokers as is practicable.
- (9) Rental rates will be determined by the Division of General Services for all leases by use of standard acceptable market rent analysis methods established by the International Association of Assessing Officers, the American Institute of Real Estate Appraisers, or other professional appraisal organizations.

B. TYPES OF LEASE TRANSACTIONS

All state leases will be categorized as one of the following five types:

1. Exempt Leases - Those leases exempted in accordance with Regulation 19-445.2120 subsection C or otherwise exempted by the Budget and Control Board.
2. Standard Leases - All leases which commit less than \$1 million in a five year period and which do not involve equity accrual.
3. Major Leases - Any lease which commits \$1 million or more in a five year period but which is otherwise standard in all respects.
4. Lease/Purchases - All lease transactions which include clauses providing for equity accrual and/or transfer.
5. Other Leases - All leases which are not encompassed by the first four categories. At its discretion, the Division of General Services may place any proposed lease transaction in this category if it involves complex issues or methodologies which warrant special handling.

C. EXEMPT LEASES

All exempt leases will be administered in accordance with regulations and procedures outlined in 19-445.2120 or Budget and Control Board directives.

D. STANDARD LEASES

- (1) The Division of General Services will be responsible for managing all aspects of soliciting lease proposals from commercial entities. In all solicitations, the Division is required to assure that equitable competition occurs in the broadest market practicable.
- (2) The Division of General Services will review all proposals from prospective Lessors with the agency or governmental body. The Division will recommend the proposal which offers the most cost effective terms and conditions to the agency or governmental body after satisfying subjective criteria such as parking, location requirements, special needs, etc. If the agency accepts the recommendation, General Services will make the selection and begin negotiations to finalize the lease transaction.
- (3) If the agency or governmental body cannot accept the Division of General Services recommendation, the dispute shall be referred to the Budget and Control Board, which will make the final determination.

- (4) Evaluation criteria shall include total cost (including rental payments, upfitting costs, escalations, additional rents, operating, and all other costs) and location. Other subjective criteria such as parking and other special needs may be included. Total cost shall be given the highest weight of any single factor.
- (5) Before making a recommendation, the Division of General Services shall verify that:
 - (a) all prior approvals have been obtained;
 - (b) adequate funds exist for the lease payments;
 - (c) lease payments are no more than fair market rental; and
 - (d) upfitting costs are no more than reasonable market costs.
- (6) The Division of General Services may reject the agency's request for additional space and/or space at a specific location.

E. MAJOR LEASES

- (1) All regulations and procedures for standard leases will apply to all major leases.
- (2) Whenever a major lease is under consideration, the Division of General Services will develop a complete written analysis comparing the total cost projected for the alternatives under consideration.
- (3) All major leases must be approved by the Joint Bond Review Committee and the Budget and Control Board before a final lease contract is awarded.

F. LEASE/PURCHASES

All regulations and procedures for major leases will apply to lease/purchase transactions.

G. OTHER LEASES

- (1) At its discretion, the Division of General Services may place any proposed lease transaction in this category if it involves complex issues or methodologies which warrant special handling.
- (2) The Division of General Services shall determine which of the above regulations are applicable to any special lease situation and may adopt additional procedures to meet special needs on a case by case basis.

H. STANDARD LEASE DOCUMENTS

(1) The Division of General Services will be responsible for drafting and updating the state standard lease document. The document will address but not be limited to the following:

Parties	Exemptions	Terms
Covenants	Location	Services
Architectural Barriers	Annual Lease Payment	Default
Untenantable Conditions	Cancellation Privilege	Assignment
Occupancy Date	Minor Repairs	Subordination
Options to Renew	Additional Provisions	Notices

(2) The state standard lease document will be used in all lease negotiations unless a substitute document is approved in advance by the Division of General Services.

(3) The state lease document will incorporate cancellation provisions including a right to cancel in the event of a (a) non-appropriation of funds for the renting agency, (b) dissolution of the agency and (c) the availability of public space in substitution for private space being leased by the agency.

(4) The Division of General Services shall also be responsible for drafting and updating a standard lease document for the leasing of public space between state agencies or others. This document will address, but will not be limited to, the items required in the state standard lease document.

DEFINITIONS

Lease A written document in which the rights to use and occupancy of land or structures are transferred by the owner to another for a specified period of time in return for a specified rent. [1]

Lease/Purchase A method of buying real property through installment or lease payments. It is based on a legal arrangement in which the unit of government becomes a tenant in a facility that is nominally owned by another entity. The relationship is termed a lease because the agency does not actually receive title to the facility until all required payments are made to the entity which financed the construction. ["Advanced Construction and Financing Methods", Building on Experience, US Dep. of Justice]

Market Rent The rental income that a property would most probably command in the open market; indicated by current rents paid and asked for comparable space as of the date of the appraisal. [1]

Upfitting The finishing work done to complete interior office space including, but not limited to, acoustical ceiling, carpeting, painting, interior walls, lighting, etc..

Escalation Clause A clause in an agreement that provides for the adjustment of a price or rent based on some event or index; e.g., a provision to increase rent if expenses increase.[1]

[1] The Dictionary of Real Estate Appraisal, American Institute of Real Estate Appraisers.

Agency Comments

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March 9, 1989

Mr. George L. Schroeder, Director
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620 NCNB Tower
Columbia, South Carolina 29201

Dear Mr. Schroeder and Ms. Edelhoach:

A review of your draft report on state leasing policies, dated March 1989 reveals it to be accurate and complete.

We wish to thank you and your staff for the time they devoted to this project and for their commitment to accurately portray the current state and Board leasing practices.

Sincerely,

Richard W. Kelly

RWK:pe
