



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #177

Sale of State-Owned Real Property (Building Commission)

Bill Agency

[LFB 2007-09 Budget Summary: Page 73, #3]

CURRENT LAW

Under 2005 Act 25, the Department of Administration (DOA), is authorized to sell any state-owned real property, with certain exceptions, if the Department determines that the sale is in the best interest of the state, subject to Building Commission approval. The DOA Secretary is required to review all holdings of state-owned real property for potential sale, except any property, facility, or institution the closure or sale of which is not authorized. The DOA Secretary is required to submit a report to the Secretary of the Building Commission containing an inventory of his or her recommendations and reasons to offer specified state properties for sale. DOA is allowed to include property in the inventory with or without approval of the state agency having jurisdiction of the property. DOA has the authority to offer the property for sale on or before June 30, 2007, if the Building Commission votes to approve the sale of any property included in the inventory. These reporting and property sale requirements would not apply after June 30, 2007, although DOA could complete transactions after that date, if approved by June 30, 2007.

Act 25 also required UW-System Board of Regents to deposit the net proceeds from real property sales after the effective date of the Act and prior to July 1, 2007 into the UW System's general operations receipts PR appropriation for the general operation of the UW System.

GOVERNOR

Sale of State Agency Properties. Modify the June 30, 2007, sunset of the 2005 Act 25 provision relating to the sale of state agency properties by extending the authority of DOA to

offer state agency properties for sale so that it applies from the bill's effective date until June 30, 2009. Under these provisions, it is estimated that \$30 million would accrue to the general fund in 2007-08.

Delete the Act 25 requirement that the DOA Secretary submit a report to the Building Commission containing an inventory of his or her recommendations of the state properties that are to be offered for sale. Rather, authorize DOA to offer for sale any state-owned real property that is eligible to be sold under the Act 25 provisions. Require that if DOA receives an offer to purchase a property, the DOA Secretary may submit a report to the Secretary of the Building Commission recommending acceptance of the offer. The report would also be required to include a description of the property and the reasons for the DOA Secretary's recommendation. Specify that if during the period on or before June 30, 2007, or the period beginning on the effective date of the bill and ending on June 30, 2009, the Building Commission votes to approve an offer to purchase a property, DOA may sell the property.

Exclude Department of Natural Resources (DNR) central or district offices from the list of properties under the jurisdiction of the DNR Board that the Board may sell if it determines the property is no longer necessary for conservation purposes and is not subject to a petition for transfer by the Department of Commerce.

Include the following properties in the list of properties that DOA could not sell under these provisions:

- a. property that is subject to sale by the Department of Military Affairs that was acquired or erected for state military purposes, but is no longer useful to the national guard or is for the purposes of a company-sized unit;
- b. property that is conveyed by the Department of Corrections related to the construction of a sanitary sewer system in the area adjacent to the Taycheedah Correctional Institution;
- c. any personal property turned over to the state treasurer as an escheat;
- d. land that is not a part of the Kickapoo valley reserve that is sold or traded by the Kickapoo Reserve Management Board;
- e. real property that is adjacent to the veterans memorial site located at the Highground in Clark County that is donated by the Department of Transportation (DOT); and
- f. the sale of real property at the Northern Center for the Developmentally Disabled by the Department of Health and Family Services.

Delete any reference to DOA's authority to sell state property from the statutes relating to the Department of Veteran's Affairs authority to manage, sell, or lease property passing to the state or members at the Veteran's Home at King. Specify that DOT's authority related to the

following types of land or property would be subject to DOA's authority to sell state-owned lands under the bill:

- a. tracts, parcels or remnants of lands acquired through purchase or condemnation, or otherwise conveyed to DOT;
- b. any disposal of rail property by DOT; and
- c. property sold by DOT that that DOT Secretary determines is no longer necessary for the state's use for airport purposes.

Repeal two cross-references to provisions that were vetoed under 2005 Act 25.

Sale of UW-System Properties. Under current law, various provisions related to the sale of properties by the UW System are only in effect until June 30, 2007. To correspond with the proposed extension of DOA's authority to sell state-owned real property through the 2007-09 biennium, the bill would also extend the following current law provisions related to the sale of properties at the UW System for a period beginning on the effective date of the bill through June 30, 2009:

- a. the provision that excludes the UW System from the list of agencies from which the DOA Secretary could sell state-owned real property;
- b. the provision that excludes moneys from the sale of UW System real property from the revenues to be deposited to the UW System auxiliary services, gifts and donations, and sale of real property appropriations; and
- c. the provisions that require that if the Board of Regents of the UW System sells any real property during the period, the net proceeds from the sale are to be deposited to the UW System's general operations receipts appropriation to be used for general operations of the System.

DISCUSSION POINTS

Current Law Authority for Property Sales

1. Prior to Act 25, typically state land or real property sales have been carried out under prior state law governing the sale of surplus lands program. Surplus lands are defined as land under the jurisdiction of the Building Commission and allocated for use by an agency, but unused and not needed for the agency's operations or included in the agency's plan for construction or development. For surplus properties surplus having a fair market value of at least \$20,000, the Commission would have to get Joint Finance Committee approval under the 14-day passive review process. Net proceeds for any sale were deposited to the budget stabilization fund.

2. The Act 25 authority superceded the existing authority of most agencies to sell,

convey, or transfer land or property, including the Building Commission's authority relative to the sale of surplus lands. If the proposed extension of the Act 25 authority for sale of state properties is not provided to DOA and the UW System, the Building Commission's authority relative to the sale of surplus land would again apply and any net proceeds from those sales would be deposited to the budget stabilization fund.

3. Under 2005 Act 25, the DOA Secretary is required to submit a report to the Building Commission specifying state properties that are to be offered for sale. DOA hired a consulting firm to review state properties and compile a list of properties that would be candidates for sale. DOA has yet to submit a report containing the inventory of properties recommended to be sold using this authority. Rather, DOA officials indicate that the Department is forwarding individual properties to the Commission as sales opportunities arise.

4. Under Act 25, the net proceeds from these property sales, after any outstanding debt related to the property being sold is paid off, are deposited in the general fund. The 2006-07 general fund balance assumes that DOA will sell \$36 million in state properties using the authority provided under the Act 25. Transactions involving the sale of state properties can be complex and have taken longer than expected to accomplish. Through April, 2007, the state has sold two separate parcels at the Department of Corrections Sanger Powers Institution in Brown County and DOA is in the process of selling the Central Services Building on Thornton Avenue in Madison and Department of Correction's surplus land at Sturtevant in Racine County, both of which could be completed in 2006-07. The following table lists these properties and the net proceeds deposited in the general fund from the sales.

<u>Property</u>	<u>Net Proceeds</u>
Corrections -- Sanger Powers Institution Land Sales	\$9,136,700
DOA Central Services Building	2,100,000*
Corrections -- Sturtevant Land Sales	<u>257,000*</u>
Total	\$11,493,700

*Estimated.

5. As indicated in the table, it is estimated that net proceeds from these property sales could total \$11.5 million by the end of 2006-07, which is \$24.5 million less than is needed to meet the \$36 million in revenues included in current 2006-07 general fund balance estimates. However, if DOA could sell \$24.5 million in properties in addition to the \$30 million in property sales estimated under the bill by the end of 2007-08, the current year shortfall would be made up in 2007-08. DOA staff indicate that they could accomplish this level of sales given the properties that they are currently working to sell. Specifically, DOA staff indicated that the sales of the DOA building and the DOT Hill Farms site in Madison would generate a significant amount toward the needed level of sales.

2007-09 Proposal

6. DOA staff indicates the authority to sell state properties is part of a larger Department initiative aimed at better managing the state's portfolio of assets. Act 25 required each state agency to report to DOA concerning the total cost of occupancy of each state owned building, structure, or facility under their jurisdiction. The cost of occupancy would include the cost to operate and maintain the physical structure of a building, the administrative costs of an agency attributable to the operation and maintenance of the building, and any debt service on borrowing attributable to the construction or improvement of the building. DOA staff intends to use this cost reporting information to better understand what each state building is costing the state to occupy and maintain. In addition, they hope to measure what each building will cost the state over the life of that building.

7. When the state sells a property, a decision has to be made as to whether the state should consolidate those staff in an existing building, construct a new, more cost efficient building, or move the agency to leased space. DOA staff has indicated that in looking at the lifetime costs of each option, they may find that in certain instances it would be less costly for the state to sell outdated buildings and lease space rather than renovate the building or construct a new building. Also, due to rapid changes in information technology, as well as changes in architecture, and office space layouts, in some cases the state may have less risk under a lease than if the state were to construct new space, or renovate old space, which may quickly become outdated. Under a lease scenario, the lessee assumes any risk associated with a space becoming outdated or obsolete while a state agency could move to a more updated space without having to make any capital outlays.

8. However, leasing space for state agency staff is not without risk for the state. The state can finance buildings and improvements at a lower cost than private sector developers due to the federal tax exemption on state bonds issued for capital improvements. In addition, state buildings are exempt from local property taxes, which lowers the annual costs associated with such buildings compared to a private building, although the state does make some payments for municipal services to municipalities on these buildings. Presumably, private developers would pass on these higher building costs in the rents charged for space leased to state agencies, and factor in a profit margin. Further, by leasing space rather than owning the space, the state would not have a long-term asset, which could offset some of the long-term liabilities associated with occupying office space. Also, as land and buildings appreciate in value, the state would have a more valuable asset by owning the property. Conversely, under a lease arrangement, the state would likely pay higher lease costs due to any appreciation in the value of the building in which the space is leased.

9. Under the bill, DOA could recommend, and the Building Commission could approve, the sale of a state building currently occupied by an agency. Subsequently, the Building Commission, under its current authority, could authorize that space be leased in order to provide space for agency staff that had been occupying that building. These lease costs would then be paid through the agency's future operating budget. These decisions could impact the future overall facility costs of state government, but would be made without review by the entire Legislature as to whether such decisions would be in the long-term interest of the state.

10. The sale of a state agency facility may also require that the state construct or purchase a replacement building for that agency's staff. For example, DOA has been reviewing the proposed sale of the DOA building at 101 East Wilson in Madison and is working with the City of Madison on a redevelopment project that could involve the eventual sale of all or a portion of the state DOT central office facility at Hill Farms in Madison. If these properties are sold, it is likely that the state would have to construct or purchase replacement buildings.

11. DOA staff indicate that net proceeds from the sale of these two facilities could exceed the \$30 million in estimated sales in 2007-08 associated with provisions in the bill. They indicate that the DOA building, due to its location, with views of the State Capitol and Lake Monona, presents a unique sale opportunity for the state. By selling the property, the state would be able to capture the significant increase in the development value of the property. According to DOA, the state could sell the building at a very good price and find accommodations for DOA staff at a lesser price. DOA would likely lease back the property from the purchaser for some period of time until another location is available for DOA staff. Approximately \$9.4 million in debt remains on the building, which was built in 1992. DOA hopes to sell the facility for up to \$30 million, which could net the state up to \$20.6 million.

12. Initially, the plan was to renovate the DOT Hill Farms office facility, which was constructed in 1964. However, a DOA review of the options for meeting DOT's space needs indicated that constructing a replacement facility would be more cost effective than renovation of the existing facility. Subsequently, DOA initiated a study of the possible sale and redevelopment of the 20.95-acre Hill Farms site. Among other things, the development would seek to better utilize the available land, provide a cost effective, long-term occupancy solution for DOT on the site, and maximize the long-term disposition of all or a portion of the site. Again, the sale of the property for redevelopment would allow the state to capture the increase in the property's development value. DOA has hired a planner, and is currently working with the City of Madison to seek approval and zoning changes necessary to implement a redevelopment plan for the site.

13. The sale of DOA and DOT state office buildings in Madison could result in the state constructing or purchasing two new facilities to house these state agencies. The state would likely issue 20-year bonds to finance the construction or purchase of the new facilities. In fact, the Building Commission's 2007-09 state building program recommendations provide \$50 million in program revenue supported borrowing for the enumeration of a replacement facility at DOT's Hill Farms office site. The recommendation indicates that the state would build or purchase space on the redeveloped site to house the DOT staff, whichever is more advantageous. DOA staff indicate that regardless of whether or not the DOA receives the extension in its authority to sell state properties, the \$50 million would be needed to construct a DOT building at Hill Farms.

14. If the DOA building is sold using this authority, the Legislature will likely be asked in the future to authorize additional borrowing authority for a replacement building. However, by that time, with no building in which to house DOA staff, the Legislature would not have much of a choice other than to approve the funding.

15. Another policy issue surrounding the selling of state assets that are still needed for state operations is how the proceeds of the sale should be used. Under the bill, the proceeds would be used to support general fund expenditures in 2007-08. However, using the DOA and DOT facilities as an example, the state would likely have 20 years of debt service payments associated with financing the construction or purchase of the new buildings since office facilities are still needed to house DOA and DOT agency staff. Therefore, the state would be selling an asset and immediately expending the proceeds from the sale. At the same time, the state would incur 20 years of future costs associated with the debt service payments from financing the new facilities.

16. A related concern is that given recent general fund budget shortfalls, there may be pressure for such sales to take place simply to assist in covering immediate budget shortfalls, rather than for reasons that are in the long-term best interest of the state. This concern may be exacerbated by the difficulty experienced in the 2005-07 biennium in attaining the necessary general fund proceeds from the property sales, which may add to the existing budgetary pressures.

17. To address these concerns, the Committee could deposit the net proceeds from the sale of state assets in the building trust fund, which is a fund that the Building Commission uses for cash funding of building program projects, although it is largely used to support advanced planning expenditures. The funds could be held in the building trust fund and then be used in lieu of issuing bonding for any replacement facility that may be needed. For example, if the net proceeds from the sale of the DOT Hill Farms building were deposited in the building trust fund rather than the general fund, the state would have to issue fewer bonds for the DOT replacement building. Assuming the state would net \$20 million from the sale of the DOT Hill Farms site, the amount of bonding needed to replace the facility could be reduced from \$50 million to \$30 million. This would reduce the estimated debt service costs over the next 20 years associated with the DOT replacement facility by \$1,650,000 annually. The disadvantage of this approach is that SB 40 includes \$30 million of revenue from these sales in its general fund balance.

Impact of Sales on State Agency Budgets

18. Another policy concern that could result from selling and rebuilding state facilities is how such decisions may impact the operating budgets of state agencies. The sale of a state facility would not only impact the operating budget of the state agency housed in that facility, but could also impact the operating budgets of other agencies that are housed in centrally-owned state office facilities. This occurs because the costs of operation and maintenance of state buildings are financed out of a central account called the space rental account, which is managed by DOA. The revenues for this account come primarily from the rents assessed state agencies that occupy space in centrally-owned state office buildings. The rent payments are made from agencies' GPR, PR, SEG, and FED general operations appropriations. It is an average cost system, which means all space shares equally in the costs, and rents are uniform across the type of facility for centrally-managed state office facilities regardless of the age, location, or cost of the state facility. For example, in Madison, all class one centrally-owned office space pays \$19.60 per square foot whether in the Risser Justice Center, which was completed in 2001, or the General Executive Facility III building completed in 1980. Increases in rental rates are sought whenever the revenues to the space rental

account are projected to be insufficient to cover costs, as determined by DOA.

19. Depending on the building, when a newly-constructed office facility comes on-line, that facility could have higher costs in the near term than the building it replaced due to the debt service on the bonds used to finance the facility. If these near term costs more than offset cost savings from having a newer, lower maintenance facility, the higher costs would need to be funded from the space rental account. If a state rental increase is needed to cover these costs, it would affect the operations budgets of most state agencies paying for class one state office space. Therefore, as an example, if state office space rental costs increase in the near term associated with constructing new DOA and DOT office facilities, a Department of Natural Resources general operations appropriation funded from fees could pay additional rent for DNR office space in Madison.

20. Depositing the net proceeds from the sale of state facility in the building trust fund rather than the general fund could alleviate the impact that the sale and replacement of a state office facility may have on the state's space rental account. Using the proceeds from the sale of such facilities in lieu of bonding when the replacement facility is constructed or purchased would reduce the future costs to the space rental account associated with the new facility.

21. A similar issue could occur if the state would lease private space associated with an office facility that is sold. For example, currently the DOA and DOT state office buildings are part of the space rental account for state office facilities. If these agencies were to lease private space, the cost of that space is usually governed by a separate specific lease for that space and rent is paid directly to the lessor. Therefore, these agencies would no longer pay into the space rental account. Depending on where the costs of the current DOA or DOT facility are relative to the \$19.60 per square foot rental rate, removing the revenue and costs associated with these facilities from the space rental account could either negatively or positively affect the rental rate for the remaining agencies that are paying into that account. This scenario would occur regardless of how the net proceeds from that sale of a facility are used.

Sale of UW-System Properties

22. SB 40 would extend by two years the Act 25 requirement that the UW System's Board deposit the net proceeds from the sale of real property to the System's general operations receipts PR appropriation for the general operation of the UW System. The Board is also required to: (a) deposit sufficient proceeds in the bond security and redemption fund to pay off any outstanding debt relating to the property; (b) pay to the federal government any of the net proceeds required by federal law, if federal financial assistance was received for the property; and (c) adhere to any restriction governing the use of the proceeds, if the property were acquired by gift.

23. During legislative deliberations on the Act 25 provision, DOA indicated that the UW System was given the authority to retain proceeds from the sale of System properties to partially offset reductions to the UW System's GPR-funded general program operations appropriation. At that time, it was estimated that providing UW System with such authority would offset \$20 million

of the GPR reduction.

24. The UW System has sold two properties under the Act 25 provisions. One parcel near the Nicolet Forest was sold for \$2.2 million to the U.S. Forest Service. The property was gifted to the UW-Madison and the proceeds from the sale went to the Nelson Institute for Environmental Studies. UW System also sold a property at UW-Stevens Point for \$125,000. System officials indicate currently there are two additional properties that could be sold in the 2007-09 biennium, one of which was also a gifted property.

ALTERNATIVES TO BILL

A. Sale of State Agency Properties

1. Approve the Governor's recommendation, which would result in an estimated \$30 million in 2007-08 being deposited to the general fund.

ALT A1	Change to Bill Revenue	Change to Base Revenue
GPR	\$0	\$30,000,000

2. Modify the Governor's recommendation to specify that the net proceeds attributable to the property sales under this provision would be deposited to the building trust fund and would be used in lieu of bonding for any replacement facility that is constructed or purchased.

ALT A2	Change to Bill Revenue	Change to Base Revenue
GPR	-\$30,000,000	\$0
SEG	<u>30,000,000</u>	<u>30,000,000</u>
Total	\$0	\$30,000,000

3. Delete provision. (The authority of DOA to sell state properties provided under 2005 Act 25 would not be extended and any sales would have to be made under the prior law governing the sale of surplus land and property.)

ALT A3	Change to Bill Revenue	Change to Base Revenue
GPR	-\$30,000,000	\$0

B. Sale of UW System Properties

1. Approve the Governor's recommendation.
2. Delete provision. (The authority of the UW System relating to the sale of the UW System properties would not be extended and any sales would have to be made under the prior law governing the sale of surplus land and property.)

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