

State Board of Equalization Building

Despite Ongoing Health and Safety Concerns, the State Has Not Thoroughly Analyzed the Costs and Benefits of Relocating Employees

Report 2014-108

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September 25, 2014

2014-108

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the State Board of Equalization (BOE) headquarters building located at 450 N Street in downtown Sacramento (building). Specifically, we were asked to assess the efforts of BOE and the California Department of General Services (General Services) to analyze the costs of needed repairs to the building, the potential loss of worker productivity and state tax revenue during repairs, and the costs and benefits of continuing to house BOE headquarters employees in the building compared to moving them to a new facility.

This report concludes that BOE has performed or commissioned several analyses on the costs and benefits of relocating its headquarters but has yet to prepare a cohesive, properly supported analysis. Many of BOE's estimates and assumptions, including its claim that it could increase state tax revenue collection by 5 percent, do not have adequate support or rationale. After expanding on BOE's analysis using much more conservative assumptions, we conclude that moving BOE headquarters to a new facility may, in fact, have net fiscal benefits for the State. However, these benefits would erode quickly if General Services does not have a plan in place for the future use or disposal of the building.

Despite its responsibility to manage the State's properties, General Services has not prepared a formal estimate for the cost of repairs needed to remediate the building and has not analyzed if maintaining ownership in the building is the most cost-effective option for the State, nor what to do with the building if BOE is allowed to move to a new facility. Without firm estimates for the costs of building repairs, the market value of the building, and potential uses for the building in the future, General Services cannot adequately provide information on what options are in the best interest of the State.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

The State Board of Equalization (BOE) administers tax programs concentrated in four general areas: sales and use taxes, property taxes, special taxes, and the tax appellate program. Headquartered in the Sacramento area in five locations, BOE has occupied the building located at 450 N Street in downtown Sacramento (building) since 1993. After initially leasing the building from the California Public Employees' Retirement System, the California Department of General Services (General Services) was authorized by legislation to purchase the building in 2006. Since at least 1994 BOE has experienced maintenance problems in the building, including water intrusion, visible mold, corrosion in drainage pipes, and spandrel glass panels falling from the building.¹ As a result, General Services has conducted several major repair projects, amounting to roughly \$60 million in repairs and upgrades to the building as of February 2014. However, continued health concerns associated with the building prompted three BOE employees in August 2014 to file a class action lawsuit against the State with the Sacramento County Superior Court, seeking up to \$75 million in damages. Since 2012 BOE and General Services have been preparing for another large repair project, believed to total roughly \$40 million.

BOE has performed or commissioned several analyses on the costs and benefits of relocating and consolidating its headquarters locations, but it has not yet prepared a cohesive, properly supported analysis demonstrating that the benefits to the State of moving BOE to a new facility outweigh the costs. As part of a business case it developed in 2013, BOE stated that it anticipates a 5 percent improvement in productivity by streamlining its business operations, potentially equating to an additional \$89 million in annual revenue that enforcement personnel such as auditors and collectors would generate. BOE staff believe that by mirroring the Franchise Tax Board's (FTB) horizontal movement of tax documents—rather than its current practice of moving documents vertically among the building's multiple floors—it will achieve gains similar to those it says FTB achieved when it moved to its current location. If actually realized, this additional revenue would dwarf any marginal differences between the costs to maintain BOE's current work space and the costs to lease a new facility. However, BOE staff were unable to provide us with documentation or assertions from FTB that such an increase in productivity

¹ Spandrel glass is an architectural material used to cover construction materials, disguise arches and columns, and present a seamless exterior to buildings.

Audit Highlights . . .

Our assessment of the State Board of Equalization's (BOE) and the California Department of General Services' (General Services) analysis of BOE's headquarters building highlighted the following:

- » *BOE has not yet prepared a cohesive, properly supported analysis demonstrating that the benefits to the State of moving BOE to a new facility outweigh the costs.*
- » *BOE staff believe that by mirroring the Franchise Tax Board's (FTB) horizontal movement of tax documents, it will achieve gains similar to those it says FTB achieved, but does not have a strong rationale underlying its assumptions.*
- » *BOE cannot support some of its estimates in its analysis of the costs and benefits of maintaining its current spatial configuration versus relocating and consolidating its headquarters.*
- » *Although it developed a methodology to estimate the lost productivity from its employees moving to, working at, and moving back from a temporary work location, BOE could not provide a strong rationale to support its estimate.*
- » *BOE's estimate of its future space needs relies on a projected annual growth rate which appears to be overstated.*
- » *After we expanded on BOE's analysis using additional components and much more conservative assumptions, we believe there could be a net fiscal benefit for the State to move BOE staff to a new facility.*
- » *Although General Services is responsible for overseeing the use of state facilities, it has not determined whether maintaining ownership and repairing the BOE building is in the best interest of the State and has no plans for using or selling the building if BOE moves.*

actually occurred when FTB moved. Further, although BOE is planning to hire a vendor to perform a study, it has not analyzed its own tax document processing to determine whether it could increase productivity by consolidating its headquarters, despite a 2010 consultant report recommending that BOE perform such an analysis. Without a strong rationale underlying its assumptions, BOE cannot clearly demonstrate the validity of its claim that relocating and consolidating its headquarters operations would result in additional revenue to the State.

BOE also cannot support critical components of an internally developed analysis of the costs and benefits of maintaining its current spatial configuration versus relocating and consolidating its headquarters. Specifically, BOE cannot support some of its cost estimates, such as the monthly lease rates for temporary space and for a new consolidated facility. Under BOE's assumptions, it appears the State would benefit from emptying the building and permanently relocating BOE headquarters staff to a new consolidated facility. However, most of this benefit is derived from BOE's assumption that remediating an empty building would cost \$20 million less than emptying and remediating only a few floors at a time. Although General Services agreed with this concept, it would not make a blanket statement that such a large reduction in costs would occur.

BOE also analyzed other aspects related to consolidating its headquarters staff at a new facility, such as the loss of productivity and state revenues from temporarily moving employees while repairs are conducted and the need for more space to accommodate potential future staffing growth. Although it developed a methodology to estimate the lost productivity from its employees moving to, working at, and moving back from a temporary work location, BOE could not provide documentation or a strong rationale to support its estimate of 80 hours of lost productivity per employee. BOE also estimated the state revenues its employees would not collect while moving to, working at, and moving back from a temporary work location, but it could not substantiate a key figure—an estimate of the amount of state revenue lost per employee. Finally, BOE has done some planning to estimate its future space needs, and as part of that planning, it relied on a projected annual growth rate in its staffing of 3 percent. However, our review of its total filled positions found that BOE's average annual growth rate has been less than 1 percent over the past 20 years. By overstating its staffing growth, BOE has overstated its need for future office space to accommodate new staff.

Because BOE's analyses included several assumptions that do not have adequate support or rationale, we performed an expanded analysis that included additional components and used more conservative assumptions for certain elements. For example,

because BOE could not support its estimated productivity gain of 5 percent after moving to a new consolidated facility, we trimmed this component of the analysis to one-tenth of BOE's expected productivity gains. We also halved BOE's estimated reduction in the costs of remediating an empty building, and we halved its estimated productivity and revenue losses from moving staff only once during a consolidation. After producing a much more conservative estimate, we still believe there could be a net fiscal benefit for the State to move BOE staff to a new facility so the building can be remediated while empty of all its employees. However, we believe any net fiscal benefits will quickly erode if the State cannot sell or find a productive use for the building after it has been remediated.

General Services is responsible for overseeing the use of state facilities; however, it has not determined whether maintaining ownership and repairing the BOE building is in the best interest of the State, and it has not made plans for using or selling the building should BOE be allowed to move to a new facility. General Services has responsibility in statute for maintaining state buildings and property and also for making the final determination on the use of existing state-owned facilities. As stated earlier, BOE and General Services have been preparing to make key repairs to the building and according to officials at General Services, representatives from trade and manufacturers associations indicated that construction associated with the failing components in the building may cost roughly \$40 million. General Services' officials stated that this figure could change once the project scope is finalized. Additionally, the State could face potentially significant legal and workers' compensation costs associated with the health concerns in the building, based on current and past litigation. Given its broad statutory authority, we would expect General Services to be more proactive in determining the value of the building and comparing that value against the repair and potential legal costs associated with the building to determine whether it should remain a part of the State's property portfolio.

Recommendations

To more clearly demonstrate its case for a new facility, BOE should do the following:

- Ensure that it has a supportable rationale for the assumptions underlying its analysis of the costs and benefits of moving to a new consolidated facility.
- Continue its plans for a study to identify inefficiencies in its current spatial configuration and how its operations could improve with a new consolidated facility.

- Incorporate staffing growth into its analysis of costs and benefits, using projections based on long-term historical data.

To ensure that it can accurately estimate any shifts in worker productivity and state revenue, BOE should strengthen its current methodology by analyzing the productivity and revenue collections of its employees and by monitoring those metrics at least semiannually. Additionally, BOE should support its methodology with documentation.

To ensure that resources are spent wisely, General Services should seek the funding and approval needed to analyze whether keeping or selling the BOE building would be in the State's best financial interest. As part of that analysis, General Services should conduct, or contract for, appraisals to assess the value of the building with and without the repairs to determine whether making the repairs is in the best interest of the State. If continued ownership of the building appears to be prudent, General Services should evaluate potential productive uses for the building should BOE move to a new facility. General Services should report the results of its analysis to the Legislature no later than September 2015.

Agency Comments

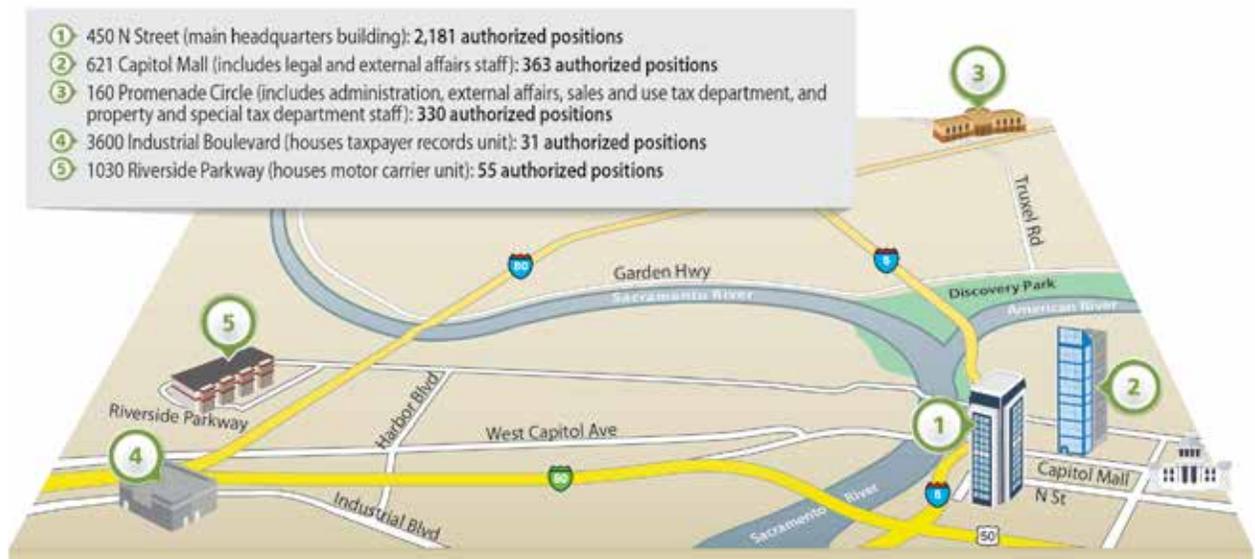
BOE and General Services indicated that they plan to implement our recommendations.

Introduction

Background

With headquarters in Sacramento, over 20 field offices located throughout the State, and three out-of-state offices, the State Board of Equalization (BOE) administers tax programs concentrated in four general areas: sales and use taxes, property taxes, special taxes, and the tax appellate program. Since 1993 BOE has occupied the building located at 450 N Street in downtown Sacramento (building), which is its main headquarters location. However, space limitations in the building require BOE to house some of its headquarters employees at four other locations in the Sacramento region, as shown in Figure 1. Initially leasing the building from the California Public Employees' Retirement System (CalPERS), the California Department of General Services (General Services) purchased the building from CalPERS after 2006 legislation authorized it to do so.

Figure 1
State Board of Equalization Headquarters Locations in the Sacramento Region



Sources: State Board of Equalization's lease data and business directory and the California Department of General Services' report titled *Relocation and Consolidation Preliminary Study: Board of Equalization* issued on June 28, 2013, and amended August 15, 2013.

Note: The authorized positions given per location are as of July 1, 2014.

According to a timeline BOE provided, maintenance problems have been an ongoing concern with the building since at least 1994, a little over a year after it was constructed. Since then the building has had problems with water intrusion, visible mold, corrosion in drainage pipes, and spandrel glass panels falling from the building.² Figure 2 shows examples of the mold and corroded drainage pipes in the building. Health concerns associated with the building problems prompted three BOE employees in August 2014 to file a class action lawsuit against the State with the Sacramento County Superior Court, seeking up to \$75 million in damages. The employees allegedly suffered from various medical conditions, such as skin rashes, respiratory problems, flulike symptoms, depression, headaches, and other serious health issues, as a result of being exposed to mold and toxic materials. Additionally, a 2009 infrastructure study conducted at the request of General Services highlighted other problems, such as structural, electrical, and mechanical concerns.

Figure 2
Visible Mold and Corroded Drainage Pipes in the State Board of Equalization Building



Sources: Photographs by Hygiene Technologies International, Inc., and the California Department of General Services' building manager.
Note: Visible mold (left) and corroded drainage pipes (right).

² Spandrel glass is an architectural material used to cover construction materials, disguise arches and columns, and present a seamless exterior to buildings.

Past and Planned Remediation of the Building

General Services began a major project in 2005 to repair seals around windows in the BOE building. During the project, the contractor that General Services selected focused on removing and examining the spandrel glass edges for defects and then replacing them. Additionally, the contractor sealed all of the glass to address water intrusion. In a September 2007 quarterly status report to the Legislature, General Services reported that the repair project had experienced delays because mold was discovered in the building. As a result, BOE relocated its employees from two floors and then limited access to those floors to construction staff working on remediating the problem. In November 2008 General Services notified BOE that all remediation and reconstruction activities on the vacant floors were complete and that they could be reoccupied. From 2009 through 2011, BOE shifted employees to vacant floors so that General Services could perform mold remediation throughout the building. Just as the floor-by-floor mold remediation work was completed, BOE reported that in January 2012 a spandrel glass panel fell from the building, prompting General Services to erect scaffolding around the building. Figure 3 on the following page shows an example of the spandrel glass panels. BOE estimates that the State has spent almost \$60 million in remediation and modernization costs for the building as of February 2014. BOE also estimates that it has spent \$2 million to settle civil claims and \$2.1 million in attorney fees associated with workers' compensation claims filed because of perceived health issues related to the building. General Services spent an additional \$1.2 million in attorney fees in response to these same claims.

Since 2012 BOE and General Services have been preparing for another large repair project. In August 2012 the California Department of Finance (Finance) authorized \$3.7 million to replace the spandrel panels at the BOE building. In late 2012 and early 2013, General Services began planning an additional repair project related to plumbing in the building. As the spandrel panel planning proceeded, General Services' cost estimates nearly doubled, from \$3.7 million to \$6.9 million. Finally, in February 2014 BOE requested and General Services agreed to change the repair project to include all required repairs, including repairs to the plumbing and the heating, ventilation, and air conditioning system as well as upgrade work, instead of only replacing the spandrel panels. We discuss this project further in the Audit Results section of this report. According to a capital outlay program manager (capital outlay manager) in its project management and development branch, General Services has received authorization from Finance to select a consultant who will be responsible for assisting General Services, in consultation with BOE and Finance, in preparing the design drawings for the repairs, which would become the basis of the scope of work for the expanded repair project.

Figure 3
Spandrel Glass Panels on the State Board of Equalization Building



Sources: California State Auditor's photograph of the State Board of Equalization's headquarters building at 450 N Street and January 2012 Glass Breakage Report by McGinnis Chen Associates Inc.

Departments Involved With BOE's Attempts to Obtain a New Facility

Since at least 2010 BOE has expressed a desire to relocate its headquarters from the BOE building to a new facility and consolidate its headquarters employees in one location. According to the capital outlay manager, General Services is not responsible for proactively determining the cost-effectiveness of consolidating BOE in a new facility; instead, that responsibility lies with BOE. Additionally, according to its deputy secretary for legal, the California Government Operations Agency—which has oversight responsibility for General Services—is not responsible for conducting a cost-benefit analysis for BOE comparing the costs of maintaining the current spatial configuration with the costs of consolidating in one facility; rather, it defers to BOE to provide this information. In 2010 BOE commissioned a consultant group of university professors to analyze the net fiscal impact to the State and develop recommendations on the best fiscal course of action regarding the BOE building. Concurrently, Assembly Bill 151—supported by BOE—would have allowed BOE to permanently move out of the building and lease a new property if the transition was cost-beneficial to the State's General Fund; however, this bill was

vetoed by the governor in part because of the State's fiscal condition at the time. More recently, BOE stated in a 2013 report General Services prepared that its business needs require that it consolidate its headquarters locations.

Various state entities would be involved in the effort to relocate BOE. According to the *State Administrative Manual*, each of the following entities may perform key roles in carrying out an infrastructure program such as a new BOE headquarters facility:

- *Client department (in this case, BOE)*: Identifies program needs, determines the related infrastructure requirements, prepares a five-year capitalized assets plan, prepares capital outlay budget change proposals, works with Finance and General Services to budget and implement the plan, and may work with the Pooled Money Investment Board (Investment Board) and the California State Treasurer (treasurer) to provide interim and long-term financing for the project.
- *General Services*: Has broad authority for real property acquisition, sales, and statewide property inventory. Its Real Estate Services Division provides real estate and property management services, such as managing the design and construction of major capital outlay and leasing projects and managing, maintaining, and operating state buildings and grounds.
- *Finance*: Reviews capital outlay budget change proposals and legislation proposing capital outlay projects and capitalized leases, may adjust the scope of projects subject to legislative reporting requirements, chairs and provides staff to the State Public Works Board (Public Works Board) in its oversight of project implementation, and has delegated authority from the Public Works Board to carry out certain board tasks.
- *Public Works Board*: Acquires property for the State, approves preliminary plans for capital projects, may set conditions for any project, and authorizes interim financing to construct facilities.
- *Investment Board*: May grant requests for Pooled Money Investment Account loans for projects needing interim financing before bonds are sold.
- *Treasurer*: Chairs the Investment Board, is a member on the Public Works Board, and is the State's official agent for the sale of debt instruments.

The Legislature passed a bill that was recently signed into law by the governor, which requires General Services to complete a long-range planning study of state office buildings in Sacramento

County and the city of West Sacramento. As part of the planning study, the legislation requires General Services to evaluate various aspects of state-owned office buildings, including condition, age, building use, and any major repairs or renovations to correct deficiencies, and it specifically requires General Services to include the BOE headquarters in this study. According to the new law, General Services must complete the study no later than July 1, 2015. In addition, the Legislature appropriated \$2.5 million to General Services in the Budget Act of 2014 for this purpose.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor to conduct an audit of BOE's costs to house its employees and to repair and maintain its headquarters office and satellite locations in the general Sacramento area. The audit analysis the audit committee approved contained five separate objectives. We list the objectives and the methods we used to address them in Table 1.

Table 1
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed the applicable laws, rules, and regulations for each objective.
2 Determine and assess, to the extent possible, any actions taken by the California Government Operations Agency (State Government Operations), the California Department of General Services (General Services), and the State Board of Equalization (BOE) to address the following: <ul style="list-style-type: none"> a. The total investment the State would have to make to repair failing components in the building at 450 N Street (building) to maintain employee and public health and safety levels, and the time frame for making those investments. b. The potential loss of worker productivity that would result from temporarily relocating employees in the building during the course of repairs. 	<ul style="list-style-type: none"> • Collected and reconciled total maintenance charges from General Services with the amount paid for maintenance BOE recorded to determine the amount expended thus far on maintenance of the building. • Reviewed and assessed General Services' cost estimates for required, normal maintenance repairs and necessary major infrastructure repairs to protect public health and safety. • Reviewed and assessed the temporary relocation costs BOE incurred during the previous remediation. Discussed those costs with General Services' staff to determine a reasonable cost estimate to temporarily relocate BOE employees for the planned remediation. • Interviewed staff at BOE and General Services to determine if any time frames have been developed for the necessary repairs. • Confirmed with State Government Operations that it has not been involved in any actions related to this objective. • Obtained and reviewed the volume of transactions BOE processed during the past 10 years. • Reviewed BOE's methodology that estimates the amount of lost productivity due to relocating its employees to and from temporary work locations. • Interviewed BOE staff to determine the length of time necessary to move employees during remediation efforts. • Confirmed with State Government Operations and General Services that their position is that worker productivity loss is something BOE must consider and mitigate.

AUDIT OBJECTIVE	METHOD
<p>c. The costs and benefits of maintaining the current spatial configuration of the building and the BOE satellite facilities, compared to the costs and benefits of housing all BOE employees in one consolidated facility.</p>	<ul style="list-style-type: none"> • Reviewed supporting documents BOE used to develop the business case presented in General Services' 2013 <i>Relocation and Consolidation Preliminary Study: Board of Equalization</i> and other studies conducted by BOE and General Services. • Interviewed relevant staff at BOE and General Services regarding the costs and benefits of consolidating BOE headquarters locations. • Prepared a cost benefit analysis of two different repair and move scenarios, using data and estimates BOE provided. • Toured the Franchise Tax Board (FTB) headquarters and reviewed documentation from FTB to compare its campus-style structure and process as an alternative for BOE headquarters operations.
<p>d. The extent to which proposals for housing BOE employees involving public-private partnerships have been considered, and whether those proposed partnerships would result in a cost savings to the State.</p>	<ul style="list-style-type: none"> • Interviewed relevant staff at General Services and BOE to determine the extent to which they have considered public-private partnerships for housing BOE employees, either temporarily for remediation or on a long-term basis with a consolidated facility. • Interviewed State Government Operations staff regarding whether they had assessed proposals for housing BOE employees involving public-private partnerships and determined that they are not involved in assessing such proposals. • Reviewed and assessed whether General Services has used public-private partnerships in the past for other real estate or relocation projects and whether they resulted in cost savings to the State. • Reviewed the definition of public-private partnerships as provided in the Legislative Analyst's Office (LAO) report released in November 2012.
<p>3 To the extent possible, determine whether State Government Operations, General Services, or BOE has assessed the effect the repair process may have on the collection of state tax revenues.</p>	<ul style="list-style-type: none"> • Reviewed and compared BOE revenue forecasts with actual revenue generated over the past 10 years to see if BOE productivity dropped during the time of the mold remediation between 2009 and 2012. • Interviewed BOE division chiefs to determine the impact on various units and validated with data to the extent possible. • Reviewed BOE's methodology that estimates the amount of revenues lost because employees are moved to and from temporary work locations.
<p>4 Determine whether BOE has projected its staffing level over the next 15 years. If not, use available data to estimate that projected growth in staffing levels.</p>	<ul style="list-style-type: none"> • Interviewed BOE's chief construction supervisor to determine and assess the methodology BOE used in developing its future 10-year space needs projection. • Obtained and examined historical total BOE staffing levels using the Wages and Salary supplements of the governor's budgets for fiscal years 1992–93 through 2014–15 to determine overall BOE filled positions for each year. • Identified and obtained the data BOE used to prepare its current and historical staffing projections, including all staffing-related budget change proposals. To the extent possible, identified headquarters employees as a percentage of the total BOE staffing. • Using staffing data BOE provided, projected BOE headquarters staffing over the next 15 years. Confirmed our methodology with BOE to get its input to ensure that we considered all relevant factors.
<p>5 Review and assess any other issues that may be significant to the audit.</p>	<ul style="list-style-type: none"> • Interviewed legal counsel at BOE and the State Public Works Board and reviewed supporting documentation to determine any issues and options available to the State related to the outstanding bonds. • Interviewed staff at the California State Treasurer's Office to develop an understanding of the outstanding bond situation and options available to the State.

Sources: California State Auditor's analysis of Joint Legislative Audit Committee audit request number 2014-108, planning documents, and analysis of information and documentation identified in the table column titled *Method*.

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Audit Results

The State Board of Equalization Cannot Support Elements of Its Analysis of the Costs and Benefits of a New Consolidated Facility

The State Board of Equalization (BOE) has performed or commissioned several analyses of the costs and benefits of relocating and consolidating its headquarters, but it has not yet prepared a cohesive, properly supported analysis demonstrating that the benefits of a new facility outweigh the costs. Most recently, BOE prepared a business case examining the benefits and costs of consolidating its headquarters and annexes in the Sacramento region, which was included in the California Department of General Services' (General Services) 2013 *Relocation and Consolidation Preliminary Study: Board of Equalization* (2013 study). In 2010 BOE commissioned an analysis of the net fiscal impact to the State of remaining in or vacating its main headquarters building located at 450 N Street in downtown Sacramento (building). BOE has also performed an internal analysis of the costs and benefits of continuing its current spatial configuration versus relocating and consolidating its headquarters. However, components of these analyses—including projected efficiencies gained by a new facility and the reduced costs of not having employees in the building while repairs are made—are not supported either with data or well-developed estimates.

BOE Has No Basis for Its Claim That a New Facility Will Increase Productivity by 5 Percent

In the 2013 study BOE stated that moving to a consolidated low-rise facility would help it streamline its business operations by allowing it to adopt a horizontal workflow similar to that used by the Franchise Tax Board (FTB). FTB also collects taxes—personal income and corporation taxes—and according to its public affairs office, its headquarters is approximately 1.85 million square feet—roughly triple the square footage of all five BOE headquarters locations. BOE stated that by streamlining its operations into a horizontal movement of tax documents and receipts rather than the vertical movement used in its current building, it anticipates a 5 percent improvement in productivity, potentially equating to an additional \$89 million in annual revenue that enforcement personnel such as auditors and collectors would generate. If actually realized, this additional revenue collected would dwarf any marginal differences between the costs of its current work space and the costs of a new facility. When we asked BOE's chief of facilities and its chief construction supervisor how BOE arrived at the anticipated 5 percent improvement in productivity and additional revenue, they asserted that it was based on how much

BOE has not analyzed its own processing operations to determine whether a new facility would increase productivity, nor has it analyzed the time frame within which it could expect to see such gains.

FTB's productivity had improved when it moved to its current location in 1985. However, they were unable to provide us with documentation or assertions from FTB that such an increase actually occurred and that it resulted from its move.

Additionally, BOE has not analyzed its own processing operations to determine whether a new facility would increase productivity, nor has it analyzed the time frame within which it could expect to see such gains. Instead, according to its chief construction supervisor, BOE relied on its observation of how FTB's operations have improved by attending a tour of FTB's headquarters facilities. However, we attended the same tour during our audit and observed that FTB benefits from its use of technology—the electronic scanning and sharing of documents in particular. The use of this technology makes the physical workflow—whether horizontal or vertical—less critical. BOE also stated in its business case that its multiple headquarters locations require staff to travel from location to location to attend meetings or deliver and retrieve documents, and that necessitates a mail courier service. However, according to its management, BOE has not performed a comprehensive study to examine the inefficiencies of its current spatial organization and how they could be eliminated by moving to a horizontal processing structure. BOE's chief construction supervisor stated that he had only a limited amount of time to put together the business case that was included in the 2013 study. Without a strong rationale underlying its assumptions for these potential improvements, BOE's business case lacks compelling evidence to demonstrate the need to relocate and consolidate its headquarters operation.

In 2010 BOE commissioned an analysis of the net fiscal impact to the State if BOE remained or vacated the building. That analysis concluded that a new facility for BOE headquarters would be the best option if BOE could demonstrate that a consolidation would increase its efficiency. The authors of the 2010 study recommended that BOE initiate an analysis of the extent to which it could enhance efficiency and better serve its mission by consolidating operations into one location. However, according to its former deputy director of administration, BOE did not implement this recommendation because General Services' oversight agency at the time, the State and Consumer Services Agency, refused to support the report and its findings.³ Moreover, the governor at the time vetoed a bill that sought to consolidate BOE's headquarters locations, in part because of the fiscal condition of the State. Without the support of the administration, BOE's management felt that ordering further studies or examining the efficiencies that it could achieve by moving to a new building was not a productive use of funds. The former deputy director also told

³ The former deputy director of administration at BOE retired during our audit and was replaced by the current deputy director of administration in May 2014.

us that BOE is planning to hire a vendor to study the extent to which BOE could improve its efficiency by consolidating operations into one location and determining the optimal design characteristics of its tax return processing areas. However, BOE has not yet completed the scope of work nor chosen a vendor to perform this analysis.

The Total Costs and Time Frame to Complete Repairs Are Still Uncertain

As we discussed in the Introduction, General Services and BOE have identified several failing components in the BOE building, including the building's spandrel glass panels, wastewater pipes, and the heating, ventilation, and air conditioning system as well as outstanding items from a previous building assessment. Under state law, General Services' responsibilities include planning, acquiring, constructing, and maintaining state buildings and property. Officials at General Services indicated that they gathered information from a prior building remediation and held discussions with representatives from trade and manufacturers associations who indicated to General Services that as of June 2014 construction associated with these failing components might cost roughly \$40 million. However, these officials added that this amount was only preliminary and could change once the project scope is finalized.

As of June 2014 General Services had not finalized a time frame for completion of all outstanding repairs. Although, in consultation with the California Department of Finance (Finance) and BOE, General Services has determined the initial scope of a combined repair project to address all identified items, the scope could be modified after General Services hires consultants to examine the building and prepare design drawings for completing the repairs. During that same month, Finance authorized General Services to expend funds to select consultants and further develop the scope of work of the repair project. Based on the initial scope of work, a capital outlay program manager (capital outlay manager) in the project management and development branch at General Services provided us with a rough time frame of almost four years from the initial selection of consultants through the completion of the construction phase of the repairs. However, according to the capital outlay manager, the time frame and scope for completing repairs also depends on how BOE moves its staff around while repairs are being completed and whether any unforeseen circumstances arise during the construction phase of the repair project. Until General Services hires the consultants and the repair project moves forward, the total costs, time frame, and scope of repairs will remain uncertain. Additionally, given current and past litigation, the State faces potentially significant legal and workers' compensation costs associated with the health concerns allegedly caused by the unresolved problems in the building, as described in the Introduction.

Given current and past litigation, the State faces potentially significant legal and workers' compensation costs associated with the health concerns allegedly caused by the unresolved problems in the building.

In addition to uncertainty about total costs, repairing the building while it is empty adds a layer of legal complexity and uncertainty. Specifically, the state constitution prohibits the State from creating debt in excess of \$300,000 unless authorized by law and approved by the voters—commonly known as the *state debt limit*. The State financed the purchase of the building using a lease-revenue bond that provides for bond investors to be paid from the proceeds of renting the building. This type of financing is considered an exception to the state debt limit. However, this exception is contingent upon the building's use and availability as an office building. Conversations between our legal counsel and legal counsel from the State Public Works Board (Public Works Board) raised concerns over whether the lack of use and occupancy during remediation of the building would mean that the bonds were no longer exempted from the state debt limit. However, legal counsel for the Public Works Board acknowledged that this scenario and its implications are only speculative at this point. This legal issue would need to be resolved if the building were to be emptied during remediation.

BOE Cannot Support Critical Components of Its Cost-Benefit Analysis

BOE performed an internal analysis of the costs and benefits of potential scenarios involved in making necessary repairs to the building. We focused on two key scenarios that BOE analyzed. The first scenario involves performing the repairs in phases by first moving four floors of employees outside of the building for the duration of the repair project, then temporarily moving the remaining employees in the building, four floors at a time, to available space within the building while repairs are conducted, and finally moving them back after repairs are completed (scenario 1). The second scenario involves moving all BOE staff out of the building as well as out of the two annexes and consolidating the staff into a new facility (scenario 2). We found that BOE had omitted several types of costs from this analysis. For example, BOE's analysis for scenario 2 did not include all of the costs to move the staff currently housed in its headquarters annexes into a consolidated facility. Its estimated leasing costs also did not take into account the larger space that would be needed in order to merge its annex staff with its current headquarters building staff. Table 2 summarizes the data BOE provided, includes this additional information, and corrects other errors. However, in making these corrections, we continued to use BOE's underlying assumptions to determine costs. In Table 2 we have used red to indicate components of the analysis that are based on assumptions for which BOE lacked adequate rationale or underlying support.

BOE's analysis did not include all of the costs to move the staff currently housed in its headquarters annexes into a consolidated facility and did not take into account the larger space that would be needed.

Table 2
Comparison of the Costs of Maintaining the State Board of Equalization’s Current Spatial Organization Versus Relocating and Consolidating Its Headquarters Locations

CATEGORY OF COSTS	SCENARIO 1 STATE BOARD OF EQUALIZATION (BOE) MAINTAINS ITS CURRENT SPATIAL CONFIGURATION		SCENARIO 2 BOE CONSOLIDATES ITS HEADQUARTERS LOCATIONS	
	AMOUNT	COMMENT	AMOUNT	COMMENT
Lease costs for headquarters	\$51,700,374	BOE lease cost for the building at 450 N Street during a BOE-estimated 3-year remediation period.	\$43,083,645	BOE lease cost for the building at 450 N Street during the period of a BOE-estimated 2.5-year phased move to a new facility.
Other lease costs calculated by BOE	19,600,000	BOE-estimated cost to lease the equivalent of four floors of space for 400 employees to provide temporary work space outside of the building during a BOE-estimated 3-year remediation period. BOE’s estimate assumes 200 square feet per employee and includes a monthly leasing rate of \$5 per square foot, plus a one-time cost of \$65 per square foot for tenant improvements to make the leased space appropriate for BOE’s needs. We used red to indicate that BOE cannot support the \$5 per square foot.	40,860,000	BOE-estimated lease cost for a new consolidated facility, which is based on BOE assumptions of a 2.5-year phased move, 500,000 square feet of space at completion, roughly \$3 per square foot, and a total cost of nearly \$31.7 million over 2 years. We included roughly \$9.1 million in lease payments for an additional 6 months because BOE’s analysis included these costs for only 2 years instead of 2.5 years.
Lease costs not included in BOE’s original move cost scenarios	12,326,004	We included the lease costs for two annexes that BOE has considered for consolidation during the 3-year remediation period, based on current lease rates, as BOE will continue to incur these costs if it maintains its current configuration. BOE did not include this amount in its analysis.	7,794,493	BOE will need 85,748 square feet of additional space, beyond the 500,000 square feet, for its new facility to maintain its current level of space. We added the cost of this extra space over a 2.5-year time period at roughly \$3 per square foot.
Building repairs	40,000,000	Provided by the California Department of General Services.	20,000,000	According to BOE, the State could save 50 percent if the building repairs are made in an empty building.
Moving expenses	2,200,000	BOE-estimated cost to move 2,200 employees to and from temporary work locations at a cost of \$500 per employee per move while building repairs are conducted.	1,221,500	BOE estimated the cost to move 2,200 employees from current work location to a new consolidated facility at a cost of \$500 per employee. We calculated the additional cost for 243 employees, as BOE plans to consolidate its headquarters building and two annexes—2,443 total employees as of June 30, 2014.
New furniture costs	2,000,000	BOE-estimated cost of \$5,000 per employee to purchase new furniture for 400 employees at a temporary work location.	12,215,000	BOE-estimated cost to purchase new furniture for 2,200 employees moved to a new consolidated facility at a cost of \$5,000 per employee. We calculated the additional costs for 243 employees, as BOE plans to consolidate its headquarters building and two annexes—2,443 total employees as of June 30, 2014.
Totals	\$127,826,378		\$125,174,638	
	Benefit of a relocation and consolidation		\$2,651,740	

Source: California State Auditor’s analysis of the BOE internal analysis of the costs and benefits of continuing its current spatial configuration versus relocating and consolidating its headquarters.

Note: BOE did not include in its analysis the costs or benefits related to lost productivity and state revenues or staffing growth. We discuss these subjects in subsequent sections.

- = Indicates BOE lacks supporting documentation.
- = Indicates BOE had sufficient supporting documentation.

Under the assumptions in Table 2, the State could benefit by roughly \$2.7 million if it emptied the building before beginning the repairs and if it permanently relocated BOE to a new consolidated facility (scenario 2). However, most of this benefit is derived from BOE's estimate that the building repairs will cost \$20 million less if the building is empty of tenants rather than if only certain floors can be worked on at a given time. General Services agrees with the concept that repairs to an empty building could be less expensive, but it would not make a blanket assumption that such a cost reduction will occur. If BOE's assumption that repair costs can be halved is incorrect, the net fiscal benefit of repairing the building when empty would be erased. For example, if the repairs to the empty BOE building cost \$30 million rather than the estimated \$20 million, the State would incur a net cost of over \$7.3 million if BOE consolidated its headquarters.

Additionally, BOE could not support several of the figures it used to estimate other lease costs, and therefore we question these costs. Specifically, BOE estimated \$19.6 million in other lease costs for the equivalent of four floors of space to temporarily house 400 of its employees during repairs to the building as part of scenario 1. To calculate this amount, BOE used a monthly lease rate of \$5 per square foot—which it could not support—plus a one-time cost of \$65 per square foot for tenant improvements to make the leased space appropriate for BOE's needs. By comparison, under scenario 2, BOE estimated the cost to lease a new consolidated facility using a monthly lease rate of roughly \$3 per square foot, which it also could not support. The \$5 per square foot for temporary space BOE used in scenario 1 may be overstated. According to information from General Services and the Downtown Sacramento Partnership, a monthly lease rate of \$3.75 per square foot may be more in line with current Sacramento real estate market conditions. If BOE's lease costs for temporary space are \$3.75 per square foot rather than \$5, the costs of maintaining its current spatial organization would be reduced by roughly \$3.6 million. This reduction itself would eliminate the overall financial benefit of scenario 2, as shown in Table 2.

BOE Could Improve Its Methodology for Estimating How Temporarily Relocating Employees Negatively Affects Worker Productivity and State Revenues

BOE also did not include in its internal analysis the costs associated with lost productivity and lost state revenues each time employees are moved. Employees must move twice under scenario 1—into a temporary location and back again after remediation—compared to once in scenario 2, in which they would make a single move to a new consolidated facility. During a prior remediation project,

BOE also did not include in its internal analysis the costs associated with lost productivity and lost state revenues each time employees are moved.

BOE developed a methodology for estimating lost productivity and revenues to inform its board members and the Legislature of the impact the remediation had on tax collections. BOE recently used this methodology to estimate the cost of lost productivity related to moving its headquarters employees. The methodology consists of multiplying the salaries paid to BOE employees who would be involved in the move by the estimated number of move-related hours per employee. As shown in Table 3, BOE assumed that each employee would lose 80 hours of productivity under scenario 1 by having to move to, work at, and move back from a temporary work location. However, we question BOE's assumption of 80 hours of lost productivity per employee. Although BOE's staff asserted that they based the 80-hour estimate on prior move experiences, they could not provide documentation to support their claims. Because BOE used an estimate that is not supported by documentation, we have shown this figure in red in Table 3.

Table 3
State Board of Equalization's Estimated Productivity Loss From Temporarily Relocating Its Headquarters Employees

	2,019	Total headquarters full-time equivalent employees
x	80	Estimated hours related to the move per employee
	161,520	Total hours to move employees to and from temporary work locations
		Average hourly salary and benefits of State Board of Equalization (BOE) employees
x	\$47.78*	
	\$7,717,067	Total productivity loss

Source: California State Auditor's analysis of BOE Employee Move Estimated Lost Productivity Calculation, April 2014.

■ = Indicates BOE lacks supporting documentation.

■ = Indicates BOE had sufficient supporting documentation.

* This amount has been rounded for presentation purposes.

BOE's methodology also estimates the revenues lost during relocation of employees, but BOE staff acknowledge that they cannot support how key figures were developed within the methodology. BOE estimated that its employees—specifically, those responsible for auditing and collecting sales and use taxes, and property and special taxes—would spend 80 hours not being productive because of moving and working in a temporary space. BOE then translated the 80 hours of lost productivity into the equivalent number of personnel years and applied that number to a figure that represents the state revenues generated per personnel year to arrive at the total of lost revenues. Again, BOE's staff asserted that they based the 80-hour estimate on prior move

experiences, but they could not provide documents to support this claim. Additionally, we question BOE’s estimate of the revenues generated per personnel year, as BOE could not substantiate the development of these amounts either. We spoke with several staff members at BOE who stated that while the figures are based on the original calculation that BOE developed in 2010, they do not have support for how those amounts were determined. Because BOE lacked the analysis to demonstrate how it calculated the revenues generated per personnel year, we have shown those figures in red in Table 4, along with BOE’s 80-hour move time estimate.

Table 4
State Board of Equalization Estimated Lost State Revenues From Temporarily Relocating Its Headquarters Employees

	SALES AND USE TAX DEPARTMENT		PROPERTY AND SPECIAL TAX DEPARTMENT	
	614		311	Number of employees in unit
x	80	x	80	Estimated hours related to the move per employee
	49,120		24,880	Total hours to move employees
÷	1,800	÷	1,800	Number of hours per personnel year
	27.29*		13.82*	Personnel years lost due to move
x	\$705,000	x	\$666,000	Revenue generated per personnel year for each unit
	\$19,238,667		\$9,205,600	Lost revenue from each unit
			\$28,444,267	Total lost revenue

Source: California State Auditor’s analysis of the State Board of Equalization’s (BOE) Employee Move Estimated Lost Productivity Calculation, April 2014.

- = Indicates BOE lacks supporting documentation.
- = Indicates BOE had sufficient supporting documentation.
- * This amount has been rounded for presentation purposes.

Despite our concerns with BOE’s lack of support for its estimates, we agree that the cost of moving its employees would be halved if BOE moved only once to a consolidated facility (scenario 2) rather than twice (scenario 1). The resulting lower estimate of lost productivity and state revenues could add to the benefit of relocating as shown in Table 2 on page 17.

In addition to the unsupported figures used in its calculation, BOE acknowledged that its methodology does not account for other lost productivity or revenues as a result of temporarily relocating employees. Specifically, managers from the sales and use tax, and property and special tax departments both stated that the methodology does not include the productivity loss related to employees who indirectly contribute to revenue collection by processing paid taxes or by providing tax policy support.

The managers stated that this loss of productivity is difficult to quantify, and for this reason, BOE has not performed any analysis of this information. Again, BOE would be able to avoid half of this potential lost productivity and revenue if it moved once to a consolidated facility rather than moving to and from temporary work space.

Regardless of whether it consolidates and relocates or continues with its current spatial configuration, we believe BOE would benefit from better supporting its methodology for calculating lost productivity and revenue. We believe that as a revenue-generating entity, BOE should be able to support its estimated productivity and revenue loss if its employees are unable to work for any reason. To make its loss estimates as accurate as possible, BOE should analyze its revenue-generating capabilities to understand how moving its employees would affect tax collections, and it should improve its ability to support any future calculations of lost productivity or tax revenues.

By Overestimating Staffing Growth, BOE Overstated the Problem of Needing Additional Office Space to Accommodate New Staff

Future staffing projections are another component BOE must consider as it makes a case to relocate and consolidate its headquarters. According to the 2013 study, BOE's headquarters locations are already near capacity, and as a result, implementation and collection of any new tax and fee programs would likely be delayed because it would have to find additional space to house new staff. Although we agree that BOE will likely have to find such additional space to house new staff, the 2013 study overstated the scope of this problem by using staff growth estimates based on the historically high growth experienced in the last five years. We believe a more reasonable estimate would result from considering more years of staffing data. However, even our more conservative estimate of staff growth indicates that unless it relocates, BOE will need additional space beyond its main headquarters building.

According to its current deputy director of administration, BOE's financial management division assists BOE's program areas in analyzing the need for additional staff as part of the normal budget process; however, the division has not conducted a 15-year staffing projection to identify BOE's potential needs for the future.⁴ She added that there are too many uncertainties that would affect a long-term projection of BOE's headquarters staffing needs, such

Even our more conservative estimate of staff growth indicated that unless it relocates, BOE will need additional space beyond its main headquarters building.

⁴ The former deputy director of administration at BOE retired during our audit and was replaced by the current deputy director of administration in May 2014.

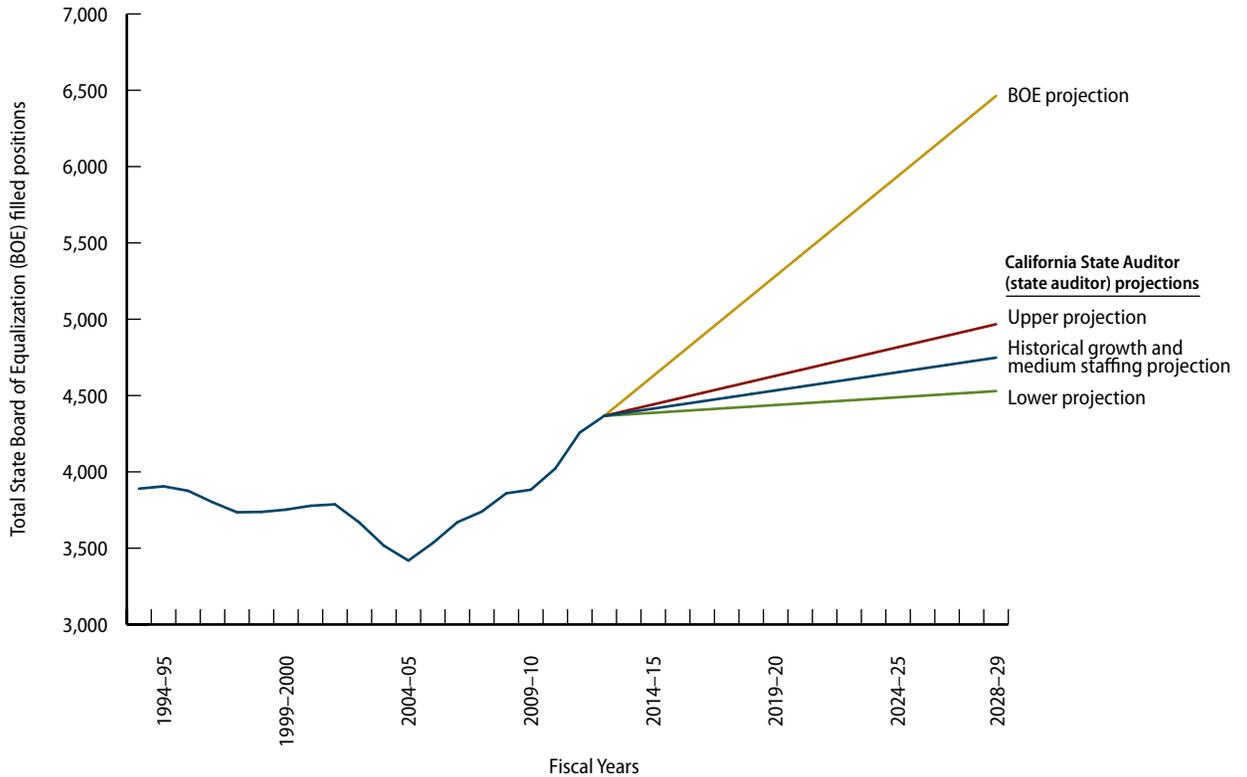
as the unknown impact of future legislative mandates. However, BOE has done some planning to estimate its future space needs. According to a draft worksheet that the chief construction supervisor prepared, BOE believes that over the next 10 years it will need to add almost 180,000 square feet of headquarters space to house its growing staff. The chief construction supervisor based this estimate on an annual staffing growth rate of 3 percent, which is similar to projections General Services included in the 2013 study. We asked the chief construction supervisor if using a 3 percent rate was reasonable, and he noted that this is close to what BOE's average growth was over the past five years and should be an accurate representation of future need.

However, we believe that a projection of 3 percent staffing growth may overestimate BOE's future growth. We reviewed BOE's total filled positions contained in the salaries and wages supplements of the past 20 governor's budgets and found that the historical average growth rate for BOE is substantially less than 3 percent. Although the average annual growth rate for BOE's filled positions over the past five fiscal years was roughly 3 percent, over the past 20 years it has been under 1 percent. Figure 4 projects BOE's staffing growth based on its historical growth over the past 20 fiscal years. For comparison purposes, we also present BOE's projected growth using its 3 percent annual growth rate. As shown in the figure, BOE's projected growth rate is significantly greater than our more conservative projections, which included a factor to account for some of the variance in the historical data.⁵

According to the chief construction supervisor, using long-term data to estimate future staffing could lead to misinterpreting BOE's staffing growth as BOE's responsibilities have changed over time. However, we believe using short-term data to estimate future staffing needs has an equal if not greater chance of miscalculating future staff levels. For example, BOE's filled positions declined by more than 4 percent from fiscal years 2002-03 through 2003-04, because of the condition of the state budget at the time. If BOE had performed its analysis using the five years surrounding this decline, it would have projected a much slower growth than it did as a result of using the most recent five years.

⁵ We calculated the standard deviation and included it in our upper and lower projections to account for some of the variation in the historical staffing data. Standard deviation is a statistical term for the amount of variation or dispersion from the average. We calculated that the standard deviation was 222 filled positions over the past 20 fiscal years.

Figure 4
State Board of Equalization Historical Filled Positions and Projections Based on Staffing Trends



Sources: BOE draft analysis of space needs and the state auditor's analysis of BOE staffing based on BOE's total filled positions shown in past governor's budgets.

Note: To determine the upper and lower projections, we calculated the standard deviation and projected 15 years of potential staffing growth starting from BOE's current number of filled positions and ending at the medium staffing projection plus and minus one standard deviation.

Although we believe that BOE's estimates are too high, using either BOE's estimate or ours, future staffing needs will result in BOE needing additional work space if its headquarters remain unconsolidated. Even with four existing satellite offices, BOE headquarters is already at maximum capacity. Table 5 on the following page shows the calculation of the potential future additional lease space and associated cost using BOE's 3 percent growth rate and the growth rate we calculated using the more conservative estimate based on the method just described. Using our methodology, BOE will require additional headquarters space in fiscal year 2020-21, amounting to just over 21,000 square feet. Then, in the following fiscal year, BOE's additional headquarters space will need to increase by roughly 3,000 square feet, for a total of 24,000 additional square feet, on top of the approximately 622,000 square feet it is currently leasing. The future lease payments associated with this additional space present a potentially significant increase in the cost for BOE to continue with its current

configuration. Even so, our analysis indicates that the space needed would not be nearly as extensive as BOE's projections indicate. As Table 5 shows, using its growth rate of 3 percent, BOE believes it will require additional space of 105,084 square feet at a cost of roughly \$3.8 million by fiscal year 2020–21; however, using a more conservative 1 percent rate of growth, we project that BOE will need only 21,364 square feet of additional space by that same year at a cost of \$776,795. BOE has not yet included in its internal cost-benefit analysis the effect of staffing growth on costs under the various options. We believe BOE could make its analysis more complete by doing so. If it includes staffing growth in its analysis, we believe BOE should use our lower projections, which are based on more years of data.

Table 5
Additional Square Footage and Lease Costs Based on Projected Staffing During the Next 15 Years

FISCAL YEAR	USING STATE BOARD OF EQUALIZATION (BOE) ESTIMATED STAFFING			USING THE CALIFORNIA STATE AUDITOR'S ESTIMATED STAFFING		
	PROJECTED HEADQUARTERS STAFFING	CUMULATIVE ADDITIONAL SQUARE FOOTAGE BASED ON STAFFING GROWTH	CUMULATIVE ADDITIONAL LEASE COST	PROJECTED HEADQUARTERS STAFFING	CUMULATIVE ADDITIONAL SQUARE FOOTAGE BASED ON STAFFING GROWTH	CUMULATIVE ADDITIONAL LEASE COST
2013–14	2,502.00			2,502.00		
2014–15	2,577.06	15,012	\$545,836	2,517.26	3,052	\$110,971
2015–16	2,652.12	30,024	1,091,673	2,532.52	6,104	221,941
2016–17	2,727.18	45,036	1,637,509	2,547.78	9,156	332,912
2017–18	2,802.24	60,048	2,183,345	2,563.04	12,208	443,883
2018–19	2,877.30	75,060	2,729,182	2,578.30	15,260	554,854
2019–20	2,952.36	90,072	3,275,018	2,593.56	18,312	665,824
2020–21	3,027.42	105,084	3,820,854	2,608.82	21,364	776,795
2021–22	3,102.48	120,096	4,366,691	2,624.08	24,416	887,766
2022–23	3,177.54	135,108	4,912,527	2,639.34	27,468	998,736
2023–24	3,252.60	150,120	5,458,363	2,654.60	30,520	1,109,707
2024–25	3,327.66	165,132	6,004,200	2,669.86	33,572	1,220,678
2025–26	3,402.72	180,144	6,550,036	2,685.12	36,624	1,331,649
2026–27	3,477.78	195,156	7,095,872	2,700.38	39,676	1,442,619
2027–28	3,552.84	210,168	7,641,708	2,715.64	42,728	1,553,590
2028–29	3,627.90	225,180	8,187,545	2,730.90	45,780	1,664,561

Sources: BOE projected staffing growth and the California State Auditor's analysis of historical staffing growth based on past governor's budgets.

Notes: We used BOE's assumption for square footage per employee—200 square feet—and its assumption for the long-term lease rate—\$3.03 per square foot—to calculate the additional lease cost from staffing growth. BOE's total headquarters space is approximately 622,000 square feet.

Our Expanded Analysis Indicates the State Would Benefit Financially by Moving BOE to a Consolidated Facility

Earlier in this report, Table 2 on page 17 presented two scenarios for accomplishing building repairs, based on information taken from BOE's internal analysis, and it concluded that the State and BOE would benefit from relocating BOE headquarters to a new consolidated facility (scenario 2). However, BOE's analysis included several assumptions that we question. Consequently, we have expanded the analysis by including additional components and using more conservative assumptions. As shown in Table 6 on the following page, our expanded analysis also concludes that BOE moving to a consolidated facility while remediation occurs on the building could have a net fiscal benefit to the State.

Table 6 includes adjustments to BOE's estimates that, as we describe in earlier sections, did not have adequate support or rationale, including repair costs and temporary lease space. For instance, because BOE could not support its estimated productivity gain of 5 percent from moving to a new consolidated facility, we reduced this estimate to one-tenth of what BOE projected as the potential productivity gain. Additionally, we reduced BOE's estimated savings on repair costs and the associated savings from a shorter repair time frame resulting from making repairs to the building while it is empty because BOE did not provide a supportable rationale for its assumptions. Also, instead of using BOE's assumed 40 hours of lost productivity and revenue each time an employee moves—a number for which, as described earlier, BOE did not have adequate support or rationale—we allowed for 20 hours of lost productivity and revenue per move. After making the adjustments described in Table 6, we believe a case can be made that moving BOE to a new consolidated facility during remediation of the existing building has net fiscal benefits.

BOE could strengthen its case even more by analyzing its own operations to identify additional gains or reduced losses from a consolidation. However, we note that any net fiscal benefits would quickly erode if the building—for which the lease is currently over \$1.4 million per month—remains empty for any significant length of time after it has been remediated. For example, under the assumptions in Table 6, if, after being remediated, the building is vacant for three months without a paying tenant, the financial benefit to the State from a BOE consolidation would disappear entirely. Consequently, while moving to a new facility would relieve BOE of a major problem it has endured for many years and may be financially beneficial overall, this decision would essentially transfer risk to General Services, which manages the State's properties. As discussed in subsequent sections, General Services has not proactively analyzed where BOE could move or what the State would do with the building should BOE no longer be the tenant.

While moving to a new facility would relieve BOE of a major problem it has endured for many years and may be financially beneficial overall, this decision would essentially transfer risk to General Services.

Table 6
Expanded Analysis Presenting Changes to Net Benefit in Table 2 Based on Alternative Assumptions

Total net benefit from consolidation from Table 2, which we prepared using the State Board of Equalization's (BOE) assumptions – \$2,651,740		
CHANGE	CALIFORNIA STATE AUDITOR (STATE AUDITOR) ADJUSTMENT	DESCRIPTION OF ADJUSTMENT
State auditor adjustments to BOE assumptions in Table 2		
Reduced BOE's estimated savings on repair costs	(\$10,000,000)	In Table 2 BOE assumes that the cost to repair the building located at 450 N Street in downtown Sacramento (building) will be \$20 million if the building is empty and \$40 million if it is not empty. Our estimate of \$10 million in savings if the building is empty represents a more conservative assumption.
Reduced BOE's estimated savings from a shorter repair time frame.	(\$19,371,062)*	In Table 2 BOE assumes a 1-year move period and a 1.5-year repair period under scenario 2. If repairs take 2 years, BOE would face additional lease costs for 6 months at both 450 N Street and in a new facility.
Reduced BOE's projected short-term leasing costs	(\$3,600,000)	In Table 2 BOE assumes a short-term monthly lease rate of \$5 per square foot to lease temporary space for its employees under scenario 1. If we used the higher of the monthly lease rates provided by the California Department of General Services (General Services) and the Downtown Sacramento Partnership—\$3.75 per square foot—the cost of scenario 1 would be less expensive and would reduce the benefit of a consolidation.
State auditor adjustments to additional benefits not included in Table 2		
Reduced BOE's productivity gain from 5 percent to 0.5 percent	\$24,475,000†	BOE assumes that it will achieve a 5 percent—\$89 million—increase in productivity by moving to a new consolidated facility. As BOE's assumption is unsupported, we conservatively assumed a 0.5 percent productivity increase each year for three years including a partial benefit during its first year of its phased move to the new consolidated facility.
Reduced the cost of lost productivity due to the need to move only once	\$1,929,267	In Table 3 BOE assumes a productivity loss of roughly \$7.7 million from temporarily moving employees in the building at 80 hours per employee so that repairs may occur. This would be reduced to 40 hours if BOE consolidates and moves only once to its new facility. However, because BOE's estimate of the number of hours per employee move seemed high, we reduced this number by half; thus, we assumed that the benefit of consolidation would be 25 percent of the total productivity loss calculated by BOE, rather than 50 percent.
Reduced the amount of lost revenue due to the need to move only once	\$7,111,067	In Table 4 BOE assumes a loss in collected revenue of roughly \$28 million from temporarily moving employees from selected units in the building at 80 hours per employee so that repairs may occur. This would be reduced to 40 hours if BOE consolidates and moves only once to its new facility. However, because BOE's estimate of the number of hours per employee move was unsupported and seemed high, we reduced this number by half to 20 hours; thus, we assumed that the benefit of consolidation would be 25 percent of the total revenue loss calculated by BOE, rather than 50 percent.
Estimated Net Benefit from Consolidation	\$3,196,011	

Sources: State auditor's analysis of data contained in tables 2, 3, and 4, and information on lease rates provided by General Services and the Downtown Sacramento Partnership.

* This total includes \$8.6 million for six months of lease costs for the building at 450 N Street (based on current lease costs of over \$1.4 million per month), plus \$10.8 million for six months of lease cost at a new facility (based on BOE's estimate of a 586,000 square foot facility at slightly more than \$3 per square foot per month).

† This total includes three years of productivity benefits from working in a new, consolidated headquarters. Generally, we used a productivity benefit total of \$8.9 million per year, which is one-tenth of BOE's estimate. However, because BOE envisions a phased move-in of employees during the first year, we reduced this first year's benefit total to \$6.675 million (75 percent of full year).

General Services and BOE Have Not Determined the Most Cost-Effective Procurement Method for a New Consolidated Facility

To procure facilities for BOE, General Services will likely contract with a private entity. We were asked to determine and assess the extent to which General Services and BOE have considered

proposals involving public-private partnerships for housing BOE employees and whether those proposals would result in a cost savings to the State. In a 2012 report, the Legislative Analyst's Office (LAO) explained that generally a *public-private partnership* means contracting with one or more private sector entities for the design, construction, finance, operation, and maintenance of an infrastructure facility. The LAO added that current state law authorizes only three departments—the California Department of Transportation, the Administrative Office of the Courts, and the California High-Speed Rail Authority—to use some form of a public-private partnership. According to the assistant deputy director of its real estate services division, General Services' contracting with private entities in the past has had similarities to public-private partnerships but differs in many ways and is not a public-private partnership by definition. He added that General Services does not have general authority to use public-private partnerships and has not sought legislative authority to use such a partnership to procure a facility for BOE. Rather, he indicated that General Services has the authority to contract with private entities to procure facilities using short-term leases and, subject to authority and funding from the Legislature, may also use lease-purchase, lease with an option to purchase, and capital outlay methods to procure a facility for BOE.

Although contracting with a private entity to provide temporary work space or a new facility for BOE is likely, neither General Services nor BOE has conducted an analysis to determine the most cost-effective action for the State. General Services and BOE have considered leasing space from private entities to temporarily house BOE employees while General Services repairs the building. BOE stated that it has not conducted any official cost analysis of straight leases because it is General Services' responsibility to procure facilities. Additionally, according to its chief construction supervisor, BOE does not have statutory authority to acquire facilities or relocate itself. The *State Administrative Manual* requires departments to initially submit a request for new or additional space to General Services and in some instances Finance's approval may be needed. According to its management, General Services will likely contract with a private entity for temporary space because there is no state-owned space in the downtown Sacramento area large enough to accommodate BOE's employees during remediation. However, according to the capital outlay manager, General Services has not done any cost analysis on potential lease options because it believes it is too early to perform such work.

General Services would also likely contract with a private entity to provide a new facility for BOE if it relocates and consolidates. Were that to be the case, General Services indicated that if

Although contracting with a private entity to provide temporary work space or a new facility for BOE is likely, neither General Services nor BOE has conducted an analysis to determine the most cost-effective action for the State.

authorized, it would likely contract with a private entity for a lease-type agreement—either lease-purchase or lease with option to purchase—to construct a new BOE facility, again because there are currently no state-owned spaces in the downtown Sacramento area large enough to house BOE. Also, according to the capital outlay manager, the scale of the project would merit using a private entity’s technical expertise. However, he further stated that General Services has not initiated discussion or conducted a cost analysis regarding the acquisition and relocation to a new facility.

While General Services has procured facilities in the past through lease-purchases and design-bid-build construction with private entities, it cannot speak to whether contracting with private entities for BOE’s relocation and consolidation project would result in cost savings to the State. The capital outlay manager stated that in general, such arrangements may save up-front costs and give the State an advantage by having a private entity take on the risks of developing a facility, but that each project’s long-term benefits are unique to the given situation. Furthermore, the capital outlay manager explained that while General Services presents economic data on lease-purchase and capital outlay procurement options to Finance at the latter’s request, Finance ultimately makes the decision on which option would result in the most desirable cost savings and benefits to the State.

General Services Should Proactively Evaluate Whether Continued State Ownership of the Building Is a Sound Financial Decision

Given the fact that BOE desires to vacate the building, General Services should be analyzing what the State would do with the building should BOE be allowed to move. However, its efforts in this regard have been very limited. According to state law, General Services makes the final determination of the use of existing state-owned facilities. Additionally, the Official Statement for the bonds issued to finance the purchase of the building state that General Services is responsible for making rental payments to the Public Works Board irrespective of the occupant of the building and that General Services would identify one or more other state agencies to occupy the building if the State decided to relocate BOE.

In the 2013 study discussed earlier, General Services identified several possible departments that could move into the space. Besides backfilling the building with other state departments, another option could be for the State to sell the building. However, according to the chief of its asset management branch, General Services has not conducted further planning to determine future uses of the building because the State has not provided General Services with the funding to do so. Although General Services

Besides backfilling the building with other state departments, another option could be for the State to sell the building.

has received funding to conduct a long-range planning study to examine the State's space and infrastructure needs and recently enacted legislation requires that study to include an assessment of the BOE building, the asset management branch chief at General Services stated that the scope of work for the planning study will not be completed until 2015.

Given its general authority in state law to manage state-owned facilities, we believe General Services should be more proactive in assessing whether the building should remain a part of the State's property portfolio. When we asked the assistant deputy director of its Real Estate Services Division why General Services had not performed an appraisal of the building, he stated that it would be challenging for an appraiser to provide an accurate value because there are no comparable properties within the Sacramento region, given the building's current condition. He also added that to conduct an appraisal, General Services would need to get funding and direction from the administration. Nevertheless, because of its broad statutory responsibilities coupled with the significant costs to repair the building and potential future legal liabilities, we believe it would be prudent for General Services to seek the funding and approval needed to analyze the future use of the building, including an appraisal, to ensure that maintaining ownership and repairing the building is the best financial decision for the State.

Recommendations

To more clearly demonstrate its case for a new facility, BOE should do the following:

- Ensure that it has a supportable rationale for the assumptions underlying its analysis of the costs and benefits of moving to a new consolidated facility.
- Continue its plans to conduct a study to identify inefficiencies in its current spatial configuration and how its operations could improve with a new consolidated facility.
- Incorporate staffing growth into its analysis of costs and benefits, using projections based on long-term historical data.

To ensure that it can accurately estimate any shifts in worker productivity and state revenue, BOE should strengthen its current methodology by analyzing the productivity and revenue collection of its employees and by monitoring those metrics at least semiannually. Additionally, BOE should support its methodology with documentation.

To ensure that resources are spent wisely, General Services should seek the funding and approval needed to analyze whether keeping or selling the BOE building would be in the State's best financial interest. As part of that analysis, General Services should conduct, or contract for, appraisals to assess the value of the building with and without the repairs to determine whether making the repairs is in the best interest of the State. If continued ownership of the building appears to be prudent, General Services should evaluate potential productive uses for the building should BOE move to a new facility. General Services should report the results of its analysis to the Legislature no later than September 2015.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the scope section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: September 25, 2014

Staff: Benjamin M. Belnap, CIA, Audit Principal
Vance W. Cable
Brian D. Boone
Vivian Chu

Legal Counsel: J. Christopher Dawson, Sr. Staff Counsel

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.



CALIFORNIA GOVERNMENT OPERATIONS AGENCY

EDMUND G. BROWN JR.
Governor

MARYBEL BATJER
Secretary



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and Government Claims
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September 9, 2014

Elaine M. Howle, State Auditor
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Re: California State Auditor's Report – 2014-108

Pursuant to the above audit report, enclosed are the Department of General Services' comments pertaining to the results of the audit.

The Government Operations Agency would like to thank the state auditor for its comprehensive review. The results provide us with the opportunity to better serve our clients and protect the public.

Sincerely,

Marybel Batjer, Secretary
Government Operations Agency

Enc.



MEMORANDUM

Date: September 9, 2014

To: Marybel Batjer, Secretary
Government Operations Agency
915 Capitol Mall, Suite 200
Sacramento, CA 95814

From: Fred Klass, Director
Department of General Services

Subject: RESPONSE TO CALIFORNIA STATE AUDITOR'S REPORT NO. 2014-108

Thank you for the opportunity to respond to California State Auditor's Report No. 2014-108, which addresses a recommendation to the Department of General Services (DGS). The audit focused on reviewing the costs to house the employees of the Board of Equalization (BOE) and to repair and maintain its headquarters office and satellite locations in the general Sacramento area.

DGS is firmly committed to effectively and efficiently providing real estate and property management services to BOE in a manner which, in partnership with BOE, ensures that building tenants and the public have a safe and healthy environment in which to conduct business, while preserving the state's investment in real property and equipment. As part of its continuing efforts to improve that process, DGS will take appropriate actions to address the recommendation presented in the report.

RECOMMENDATION

RECOMMENDATION: *To ensure that resources are spent wisely, General Services should seek the funding and approval needed to conduct an analysis to determine whether keeping or selling the BOE building would be in the State's best interest financially. As part of that analysis, General Services should conduct, or contract for, appraisals to assess the value of the building with and without the repairs to determine whether making the repairs is in the best interest of the State. If continued ownership of the building appears to be prudent, General Services should evaluate potential productive uses for the building should*

Marybel Batjer

-2-

September 9, 2014

BOE move to a new facility. General Services should report the results of its analysis to the Legislature no later than September 2015.

DGS RESPONSE:

DGS will seek the necessary approvals and funding for it to conduct an analysis to determine whether keeping or selling the BOE building is in the state's best interest financially. A key component of the proposed analysis will be an appraisal to assess the value of the building under various scenarios. The analysis will be planned for completion and reporting to the Legislature by September 2015.

In addition, if the state continues to own the 450 N Street building and BOE is approved to move to a new facility, DGS will fully evaluate potential uses for the building including backfilling the space with other state tenants.

If you need further information or assistance on this issue, please contact me at (916) 376-5012.



Fred Klass
Director

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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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Fourth District, Los Angeles
JOHN CHIANG
State Controller
CYNTHIA BRIDGES
Executive Director

September 9, 2014

Ms. Elaine Howle, CPA*
State Auditor
California State Auditor
621 Capitol Mall
Suite 1200
Sacramento, CA 95814

Dear Ms. Howle:

The State Board of Equalization (BOE) would like to thank the California State Auditor's Office (CSA) for its recommendations contained in the *Board of Equalization Building* draft report provided on September 3, 2014. The BOE agrees with the CSA's belief that there could be a net fiscal benefit for the State to move BOE staff to a new facility, which would allow the 450 N Street building to be repaired while vacant. In responding, the BOE wants to emphasize that in 2009, when remediation began in the 450 N Street building, we were assured repairs to the building would be complete in all aspects. Since repairs were completed in January 2012, however, the BOE has experienced additional building repair issues. Consequently, to facilitate a timely response, the BOE has prepared draft estimates in lieu of more formal estimates. These estimates were developed to show the potential cost benefit of consolidating the BOE headquarters employees and remediating the 450 N Street building while vacant.

The following is the BOE's response to CSA's findings and recommendations.

Recommendations as stated in California State Auditor (CSA) Report:

To more clearly demonstrate its case for a new facility, BOE should do the following:

- *Ensure that it has a supportable rationale for the assumptions underlying its analysis of the cost and benefit of moving to a new consolidated facility.*

BOE's Reply:

The BOE plans to conduct a Time-In-Motion study to determine the costs and benefits of moving to a consolidated facility. The scope of work for a Time-In-Motion study has been prepared. The BOE's next step will be to solicit responses to a formal bid. The BOE expects a contract to be in place within six to nine months of receiving responses to the bid.

- *Continue its plans to conduct a study to identify inefficiencies in its current spatial configuration and how its operations could be improved with a new consolidated facility.*

BOE's Reply:

The BOE plans to conduct a Time-In-Motion study to determine the costs and benefits of moving to a consolidated facility. The scope of work for a Time-In-Motion study has been prepared. The BOE's next step will be to solicit responses to a formal bid. The BOE expects a contract to be in place within six to nine months of receiving responses to the bid.

①

* California State Auditor's comments begin on page 39.

Ms. Elaine Howle, CPA

September 9, 2014

- *Incorporate staffing growth into its analysis of cost and benefits, using projections based on long-term historical data.*

BOE's Reply:**Staffing Growth:**

While it was noted the BOE's 20-year staffing growth was calculated at less than 1% by the CSA, the BOE used the 3% staffing growth rate over a five-year period because we believe it more accurately reflects present-day growth. However, based on the recommendations stated in the CSA report, the BOE has changed the annual staffing growth to 1% (Figure 4) in the draft estimate of future rental costs for the Headquarters and annex facilities.

The BOE will need to allow for adjustments to this growth rate based on existing and potential legislative mandates (e.g., Fire Prevention Fee, and proposed Pre-Paid Mobile Telephony Service Surcharge) that likely will impact our staffing.

Rental Escalation Factor:

Based on BOE's review, the rental inflation escalation appears understated at the 1% rate and should be 3% to be consistent with the Department of General Services' typical estimates.

②

To ensure that it can accurately estimate any shifts in worker productivity and revenue, BOE should strengthen its current methodology by analyzing the productivity and revenue collection of its employees and monitor those metrics at least semiannually. Additionally, BOE should be able to support its methodology with documentation.

BOE's Reply:

③

Due to discussions with the State Auditor during the review of the 450 N Street Headquarters building, BOE developed a new methodology to track the productivity and revenue collection of auditors and collectors. The methodology has been documented and can be repeated on a regular schedule, as needed.

Furthermore, the BOE will continue to quantify and document the disruption to work and the lost productivity associated with moving/relocating auditors and collectors and will enhance standard measures to depict productivity associated with workflow during staff moves and relocations.

④

The BOE concurs with the savings outlined in the State Auditor's report. The State Auditor's report indicates BOE's rental factors did not include moving annex employees into the consolidated location. Previously, BOE prepared a comprehensive rental comparison that incorporated consolidating the annex locations in a new campus (see attached Exhibit 1).

As noted in the report, the BOE has been served with a lawsuit claiming damages of \$75 million. However, the BOE will not be in a position to evaluate the associated risks until discovery is complete.

Regards,



Cynthia Bridges
Executive Director

Ms. Elaine Howle, CPA

September 9, 2014

CB:bw

Attachment

cc: Mr. Randy Ferris
Mr. David Gau
Ms. Edna Murphy
Ms. Michele Pielsticker
Mr. Brock Wimberley

EXHIBIT 1 (BOE-Building Audit)

DRAFT

Facility	14/15			15/16			16/17			17/18			
	Sq Footage	Per Sq Ft	Per Month	Per Sq Ft	Per Month	Per Year	Sq Footage	Per Sq Ft	Per Month	Per Year	Sq Footage	Per Sq Ft	Per Year
450 N St. - Office	449,138	\$3.16	\$1,419,276.08	\$3.17	\$1,019,697.07	\$12,236,364.84	71,671	\$3.17	\$227,197.07	\$2,726,364.84			\$0.00
450 N St. - Storage	14,077	\$1.02	\$14,358.54	\$1.02	\$14,358.54	\$172,302.48	7,039	\$1.02	\$7,179.27	\$86,151.24			\$0.00
621 Capital Mall	61,544	\$3.30	\$203,095.20		\$0.00	\$0.00			\$0.00	\$0.00			\$0.00
160 Promenade Cir	60,989	\$2.31	\$140,884.59		\$0.00	\$0.00			\$0.00	\$0.00			\$0.00
Projected Growth	5,932	\$3.00	\$17,796.00	\$3.03	\$18,153.70	\$217,844.40	6,051	\$3.06	\$18,518.59	\$222,223.07	6,112	\$3.09	\$226,689.75
Previous Growth	0	\$0.00	\$0.00	\$3.03	\$17,973.96	\$215,687.52	11,923	\$3.06	\$36,488.94	\$437,867.23	Included		
New Facility	0	\$0.00	\$0.00	\$3.00	\$750,000.00	\$9,000,000.00	500,000	\$3.03	\$1,515,000.00	\$18,180,000.00	596,684	\$3.06	\$21,912,386.50
Total	591,680		\$1,795,410.41		\$1,820,183.27	\$21,842,199.24	596,684		\$1,804,383.87	\$21,652,606.38	602,796		\$22,139,076.25
Facility	18/19			19/20			20/21			21/22			
	Sq Footage	Per Sq Ft	Per Month	Per Sq Ft	Per Month	Per Year	Sq Footage	Per Sq Ft	Per Month	Per Year	Sq Footage	Per Sq Ft	Per Year
Projected Growth	6,173	\$3.09	\$19,074.15	\$3.12	\$19,451.93	\$233,423.11	6,297	\$3.15	\$19,835.35	\$238,044.24	6,360	\$3.18	\$242,694.05
New Facility	602,796	\$3.09	\$1,863,183.34	\$3.12	\$1,901,085.69	\$22,813,028.33	615,203	\$3.15	\$1,939,754.41	\$23,277,062.88	621,500	\$3.18	\$23,750,459.14
Total	608,969		\$1,882,257.49		\$1,920,537.62	\$23,046,451.44	621,500		\$1,959,589.76	\$23,515,077.11	627,860		\$23,993,153.19
Facility	22/23			23/24									
	Sq Footage	Per Sq Ft	Per Month	Per Sq Ft	Per Month	Per Year							
Projected Growth	6,424	\$3.22	\$20,683.69	\$3.25	\$21,085.16	\$253,021.90							
New Facility	627,860	\$3.22	\$2,019,453.02	\$3.25	\$2,060,514.76	\$24,726,177.13							
Total	634,284		\$2,040,136.71		\$2,081,599.92	\$24,979,199.03							

Population Growth is based on a 1% per annum rate increase.
Rental appreciation is based on a 1% per annum rate increase.

ESTIMATE

8/19/2014

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE STATE BOARD OF EQUALIZATION

To provide clarity and perspective, we are commenting on the State Board of Equalization's (BOE) response to our audit. The numbers below correspond to the numbers we have placed in the margin of BOE's response.

BOE is too narrow in its interpretation of our recommendation. The study BOE describes would provide support for some components of its cost-benefit analysis, but it would not provide supportable rationale for all underlying assumptions. For example, as we describe on page 18, certain assumed lease costs in the analysis also need support. A time and motion study would not provide this and all other components of the analysis.

①

This rental escalation factor to which BOE refers is entirely independent of the rate of staffing growth referred to in our recommendation. Further, BOE is referring to its own assumption of a 1 percent escalation in future rents on leased facilities, a factor it had no support for during the audit. If BOE now believes rent increases of 3 percent is more reasonable and has adequate support, then it should make whatever adjustments are necessary to its analysis. We look forward to reviewing the support for this factor in BOE's 60-day response to the audit.

②

Although BOE may have developed a new methodology to track the productivity and revenue collection of its auditors and collectors based on discussions with our auditors, we have not seen or evaluated this new methodology. Therefore, we look forward to reviewing it as part of BOE's 60-day response to this audit.

③

BOE refers to and attaches an exhibit it did not fully use in its own cost-benefit analysis. On page 22 we describe the draft worksheet that the chief construction supervisor prepared, which BOE attached to its response and refers to as exhibit 1. When analyzing the costs and benefits of consolidating its staff into a new facility, BOE did not include all of the needed square footage in its calculation. As a result, its cost-benefit analysis was incomplete, as we describe on pages 16 and 17.

④