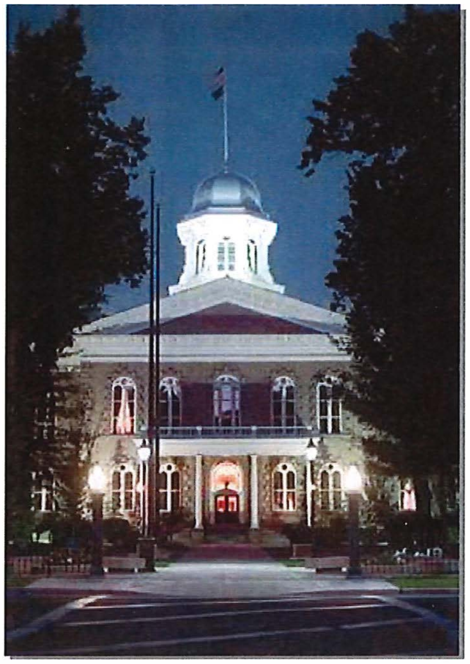

State of Nevada
Governor's Finance Office
Division of Internal Audits

Audit Report

Department of Administration
State Public Works Division

Long-Term Office Space Planning Mechanism

DIA Report No. 20-10
July 6, 2020

EXECUTIVE SUMMARY
Department of Administration
State Public Works Division
Long-Term Office Space Planning Mechanism

Introduction .... page 1

Objective: Develop a Long-Term Office Space Planning Mechanism to Optimize State-Owned Office Space

Propose Legislation to Implement and Maintain a Long-Term Statewide Office Space Needs Assessment .... page 2

Executive Branch officials and legislators make capital improvement decisions without the full context of long-term office space needs, which are often competing against other more appealing projects. Proposing legislation to implement and maintain a long-term statewide office space needs assessment will establish the necessary authority to coordinate a process that compiles, analyzes, summarizes, and prioritizes information about long-term office space needs. This information will facilitate informed capital project decisions for executive and legislative branch officials. The level of commercially leased office space is the result of a default position rather than a deliberative process. A high percentage (67%) of executive branch office space is leased and has been for several decades.

Other states adopted statutory provisions to regularly monitor, update, and report long-term facility needs either through the budget process or independently through an established board or commission. Statutory provisions in surveyed states were intended to address information gaps like Nevada's. This information was needed to: improve cost-control and efficiency over management of state building facilities; allow state leadership to understand investment decisions within a relevant context; identify the most cost-effective alternatives; or improve the cost effectiveness of state facility alternatives.

Ownership is sometimes preferable to leasing. Lessors accrue substantial long-term economic benefits through recovery of ownership costs and, additionally, returns on investment over the life of the building that would otherwise accrue to the state. Legacy ownership claims include intangible benefits not measured through financial analysis. These benefits can be significant and include valuable local, regional, or state cultural and historical community landmarks. Many of the buildings that house agencies in leased office space are not ideally situated, optimally utilized, or built to the state's construction standard but may be less costly in the short, medium, and even long term. However, sometimes it may be advantageous from the state's perspective to pursue an ownership strategy when economic factors indicate favorable long-term benefits. The State Public Works Division (SPWD) expects to fully implement the recommendation by July 2022.

Require Agencies to Biennially Submit Updated Long-Term Facility Needs .... page 7

A long-term facility needs plan is not possible without an on-going commitment from agencies to push base information into a process that compiles, analyzes, and reports results to decisionmakers. Requiring agencies to biennially submit updated long-term facility needs will provide information to assist executive and legislative officers with capital improvement decisions.

Other states' long-term facility needs plans are agency-driven. Surveyed states require agencies to provide regular facility needs updates used as the basis for preparing long-term statewide facility needs plans. Agency turnover necessitates mandated agency participation. Mandating agency participation in long-term facility planning ensures continuity despite agency turnover. The state's average commercial office space lease term is approximately seven years, sometimes with multiple renewals leading to decades of occupancy in the same location. During that time, it is not uncommon for agency leadership to evolve due to retirements and re-assignments. Agency facility needs may not be considered until lease renewal, at which time long-term planning may not be an option. If mandated, agency leadership would provide long-term facility needs to SPWD on a routine basis, informing the compilation, analytical, and reporting process to provide policymakers a basis upon which to prioritize office space capital projects.

Currently, a facility needs assessment is only available through commissioned master plan studies of various state-owned complexes. Master plans do not give policymakers an overall, continual picture of statewide office space needs. Instead, master plans are static, regional, and intermittent. SPWD expects to fully implement the recommendation by July 2022.

Identify Consolidation Opportunities to Reduce Reliance on Leases for Office Space Needs..page 9

Nevada is unable to optimize the state's portfolio of owned and leased office space because it lacks an on-going process to identify economical consolidation opportunities. Identifying economical consolidation opportunities is a critical element of strategic planning for long-term facility needs. The long-term needs of agencies must be considered together in order to identify compatible missions with geographic suitability, as was done in the 2015 Capitol Complex and Bradley Government Campus Development Study, which identified long-term savings in excess of $100 million at 30 years, with an estimated residual buildings value of $54 million. Expertise is required to analyze lease-purchase options, and consolidation plans must be updated in order to be executed in a timely fashion to benefit from fleeting economically favorable conditions which can be a challenge in a biennial legislative process. SPWD expects to fully implement the recommendation by July 2022.

Develop Lease-Purchase Model to Estimate the Cost of Long-Term Office Space Options...... page 12

A proposal for long-term office space needs cannot be initiated outside of the lease renewal process because a decision model is currently not available. Developing lease-purchase models to estimate the cost of long-term options will identify potential savings to the state to pursue when prioritizing capital projects. Surveyed states have lease-purchase models readily available as a tool to perform preliminary cost analysis of long-term lease-purchase options. These models identify investment opportunities and inform leasing terms. SPWD expects to fully implement the recommendation by July 2022.

Incorporate Analysis of Long-Term Statewide Office Space Needs into the Capital Improvement Plan Reporting Structure .... page 14

Decisionmakers do not have the full context prioritizing and selecting building projects because Nevada lacks a reporting mechanism for a long-term statewide facility needs assessment. Incorporating analysis of long-term, statewide office space needs into the CIP reporting structure will provide executive branch officers and legislators needed context and supporting analysis as they contemplate CIP projects and consider lease versus own decisions with a long-term view. Other states' long-term statewide facility needs plans include reporting mechanisms that include summary and supporting analysis through the capital projects approval process in the executive and legislative branches. SPWD expects to fully implement the recommendation by July 2022.

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Timetable for Implementing Audit Recommendations

INTRODUCTION

At the direction of the Executive Branch Audit Committee, the Division of Internal Audits conducted an audit of the Department of Administration, State Public Works Division's (SPWD), Long-Term Office Space Planning mechanism. Our audit focused on SPWD's lack of long-term office space planning. The audit's scope and methodology, background, and acknowledgements are included in Appendix A.

Our audit objective was to develop recommendations to:

✓ Develop a long-term office space planning mechanism to optimize state-owned office space.

Department of Administration State Public Works Division Response and Implementation Plan

We provided draft copies of this report to SPWD for review and comment. SPWD's comments have been considered in the preparation of this report and are included in Appendix B. In its response, SPWD accepted our recommendations. Appendix C includes a timetable to implement the recommendations.

NRS 353A.090 requires within six months after the final report is issued to the Executive Branch Audit Committee, the Administrator of the Division of Internal Audits shall evaluate the steps SPWD has taken to implement the recommendations and shall determine whether the steps are achieving the desired results. The administrator shall report the six-month follow-up results to the committee and SPWD officials.

The following report (DIA Report No. 20-10) contains our *findings, conclusions*, and *recommendations.*

Respectfully,

Warren Lowman
Administrator

Develop a Long-term Office Space Planning Mechanism to Optimize State-Owned Office Space

The State Public Works Division (SPWD) should develop a long-term office space planning mechanism to optimize state-owned office space by:

- Proposing legislation to implement and maintain a long-term statewide office space needs assessment;
- Requiring agencies to biennially submit updated long-term facility needs;
- Identifying economical consolidation opportunities to improve efficiencies and reduce reliance on leases for office space needs;
- Developing lease-purchase models to estimate the cost of long-term options; and,
- Incorporating analysis of long-term statewide office space needs into the Capital Improvement Plan reporting structure.

Developing a long-term office space planning mechanism to optimize the balance between owned and leased office space will ensure the residual benefits of ownership accrue to the state and commercial leases are the result of a deliberate process and not a default position.

Propose Legislation to Implement and Maintain a Long-Term Statewide Office Space Needs Assessment

The State Public Works Division (SPWD) should propose legislation to implement and maintain a long-term statewide office space needs assessment. Unlike other states, Nevada has no statutory requirement to maintain a continual, statewide, long-term facilities planning mechanism.[1] Opportunities may be missed to strategically implement building projects that, over time, reduce reliance on commercial leases, house agencies in facilities that better fit their missions, and accrue the benefits of ownership to the state.

High Percentage of Office Space is Leased

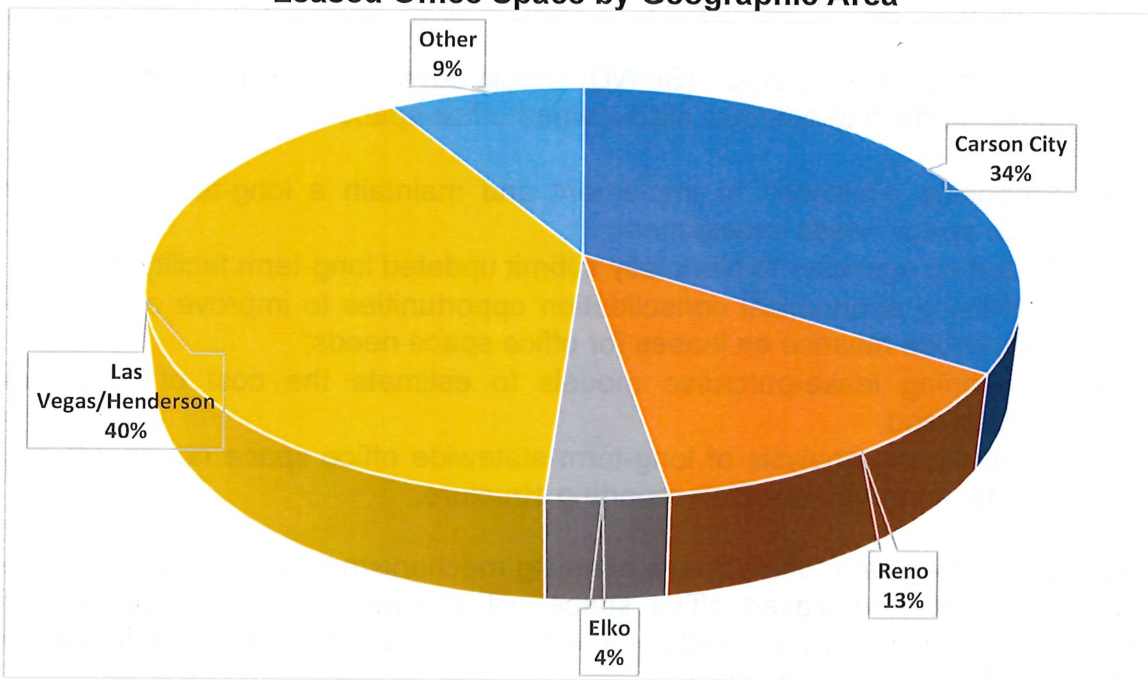
A high percentage of office space is leased. Nevada's executive branch office space needs are comprised of 291 commercial leases for 2.1 million square feet, amounting to 67% of the state's 3.2 million square feet of office space.[2] SPWD manages 1.1 million square feet of owned state office space through the Buildings and Grounds Section (B&G). Collectively, the 291 office leases represent

[1] Surveyed states: Idaho, Oregon, Utah, and Washington.
[2] Does not include office space of Nevada System of Higher Education or Nevada Department of Corrections.

approximately $41 million of annual commitments funded by client agencies.[3] See Exhibit I.

Exhibit I

Leased Office Space by Geographic Area



Source: SPWD, B&G, Leasing Services FY 20 Master Lease Log.
Note: "Other" includes rural counties and rural areas of Clark County.

Other States Adopted Statutes to Address Long-Term Facility Planning

We surveyed other states and found they have adopted statutory provisions to regularly monitor, update, and report long-term facility needs either through the budget process or independently through an established board or commission.[4] See Exhibit II for a summary of surveyed states' long-term facility plans.

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[3] Approximately one third of leases representing approximately one half of leased office space involve foreign (non-Nevada) landlords.

[4] Idaho Revised Statutes 67-5708B (House Bill 486); Oregon Revised Statutes 276.27 State Facility Summary (Part 1 – Portfolio and Part 4 – Planning and Drivers which includes 10-year strategic facilities plan) DAS/CFO/FPU ORS 276.227 established the FPU 2013-2015 Capital Planning Advisory Board and Capitol Planning Commission. See also Executive Order 12-17; Utah Code Title 63A Chapter 5; Revised Code of Washington 43.82.055 (Also Intent 2007 C506).

Exhibit II

Surveyed States' Long-Term Facility Plans

State	Plan Type	Year Adopted	Update Frequency
Idaho	Five Year Facilities Needs Plan	2000	Annually
Oregon	Ten Year Strategic Facilities Plan	1997	Biennially
Utah	Five Year Building Plan	2017	Biennially
Washington	Six Year Facilities Needs Plan	2007	Biennially

<u>Statutory Provisions in Surveyed States</u>
<u>Intended to Address Information Gap</u>

Statutory provisions in other states were established to address information gaps that failed to provide executive officers and legislators complete information when making capital improvement decisions. This information was needed to improve: cost-control and efficiency over management of state building facilities; allow state leadership to understand investment decisions within a relevant context; identify the most cost-effective alternatives; or, improve the cost effectiveness of state facility alternatives.

Ownership is Sometimes Preferable to Leasing

Ownership is sometimes preferable to leasing because it incurs lower costs over the long-term, provides office space more suitable to each agency's mission, and is built to the most current energy efficiency standards. Residual and legacy claims of ownership accrue to the state.

<u>Lessors Accrue Substantial</u>
<u>Long-term Economic Benefits</u>

Lessors accrue substantial long-term economic benefits through recovery of ownership costs and, additionally, returns on investment from lease income received over the life of the building. This cost recovery includes:

- A return of investment - land, construction, and maintenance costs; and
- A return on investment based on the investor's cost of capital (cost of equity and cost of debt).

Commercial lessors pay a higher cost of capital because they must acquire debt or secure funding through private sector sources; whereas, the state's cost of capital (debt) is lower due to its tax-exempt bonding authority.[5] Consequently, the state has an advantage in raising capital at a lower cost to fund its construction projects.

From a purely cost perspective, a balancing consideration is the state's standard of construction which increases the cost to meet its longer life cycle, higher energy efficiency, and labor/input mandates. Many of the buildings that house agencies in leased office space are not ideally situated, optimally utilized, or built to the state's construction standard but may be less costly in the short, medium, and even long term.

Noneconomic Factors When Considering Ownership

Cost comparison is not the only consideration when evaluating whether to own a facility. The state may choose leasing for a variety of reasons, including:

- The need to be close to customers, which may shift over time;
- The expected length of occupancy;
- Shifting the fiscal responsibility for maintenance to the lessor;
- The availability of funds in the operating or capital budget; or
- How quickly office space is needed.

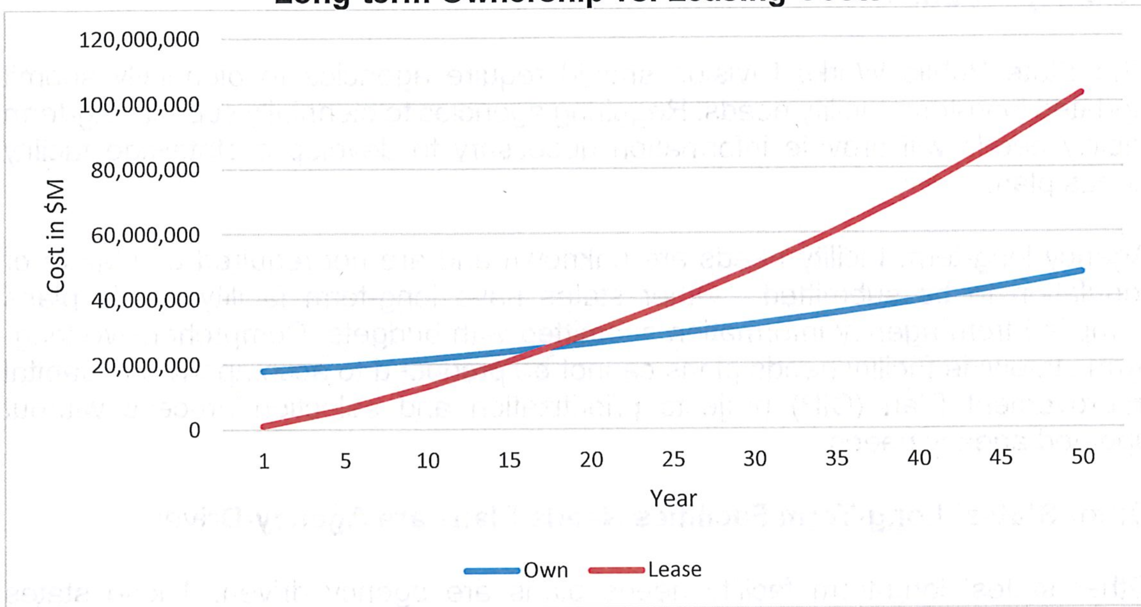
However, sometimes it may be advantageous from the state's perspective to pursue an ownership strategy when economic factors indicate favorable long-term benefits. Interest rates, economic growth forecasts, lease rates, labor costs, material costs, and other factors must be considered when making long-term ownership versus leasing decisions. An example of a decision showing the long-term benefits of ownership is illustrated in Exhibit III.[6]

[5] A Lease-Lease Back structure permits the opportunity to use tax exempt bond financing, coupled with a Not-for-Profit borrower, to build facilities making the debt "non-recourse" to the Sate with minimal, if any, impact on future bonding capacity. Nevada Real Property Corporation was created in 1998 to facilitate this type of financing structure.

[6] Exhibit II is reconstructed from the Utah Division of Facilities Construction and Management Lease-Buy presentation on June 19, 2018. It assumes replacing the leased DCFS building in Sandy Utah with a new building, same square footage. The 50-year lease cost is $102.7 million versus the 50-year cost of ownership of $47.4 million. Lease costs = 54,300sf @ $1.89sf/month plus 2% annual growth in lease rate. Own costs = $18,076,000 construction cost, $239,000 annual operations and maintenance, and $199,000 annual capital improvements.

Exhibit III

Long-term Ownership vs. Leasing Costs



Source: Utah Division of Facilities Construction and Management Lease-Buy presentation on June 19, 2018.

<u>Owners May Accrue
Intangible Benefits</u>

Legacy ownership claims include intangible benefits not measured through financial analysis. These benefits can be significant as valuable local, regional, or state cultural and historical community landmarks. Customized state-owned buildings may be constructed to: provide a sense of welcome; promote efficient use of the site; and help educate tourists, residents, and businesses about Nevada history and culture. Two examples are the Capitol Building and the Legislature Building that are centers of current and historic state government activity.

Conclusion

Nevada lacks a long-term statewide office space planning mechanism. Proposing legislation to implement and maintain a long-term statewide office space needs assessment will establish the necessary authority to coordinate a process that compiles, analyzes, summarizes, and prioritizes information about long-term office space needs. This will facilitate informed capital project decisions for executive and legislative branch officials.

Recommendation

1. Propose legislation to implement and maintain a long-term statewide office space needs assessment.

Require Agencies to Biennially Submit Updated Long-Term Facility Needs

The State Public Works Division should require agencies to biennially submit updated long-term facility needs. Requiring agencies to biennially submit long-term facility needs will provide information necessary to develop a statewide facility needs plan.

Agency long-term facility needs are unknown and are not required by statute or regulation to be submitted. Other states have long-term facility needs plans compiled from agency information submitted with budgets. Comprehensive long-term statewide facility needs plans cannot be produced to accompany the Capital Improvement Plan (CIP) projects prioritization and selection process without updated agency needs.

Other States' Long-Term Facilities Needs Plans are Agency-Driven

Other states' long-term facility needs plans are agency driven. These states require agencies to provide regular facility needs updates used as the basis for preparing statewide plans. For example:

- Idaho – Agencies are required to prepare a 5-year facilities needs plan, updated the plan annually, and report projected facility needs at annual budget hearings.
- Oregon – Agencies provide biennial updates to inform the 10-year Strategic Capital Investment Plan administered by the Facilities Planning Unit and presented biennially to the legislature.
- Utah – Agencies biennially provide data that is compiled and analyzed by the Utah State Building Board to perform life-cycle cost analysis and prioritize projects for presentation to the legislature.
- Washington – Agencies provide updated Six-Year Plan data in the spring of even-numbered years for analysis by the Office of Financial Management and inclusion into the statewide Six-Year Plan.

<u>Agency Turnover Necessitates
Mandated Agency Participation</u>

Mandating agency participation in long-term facility planning would ensure continuity despite agency turnover. The state's average commercial office space lease term is approximately six years, sometimes with multiple renewals leading to decades of occupancy in the same location. During that time, it is not uncommon for agency leadership to evolve due to retirements and re-assignments. Agency facility needs may not be considered until lease renewal, at which time long-term planning may not be an option. If mandated, agency leadership would provide long-term facility needs to SPWD on a routine basis, informing the compilation, analytical, and reporting process to provide decisionmakers a basis upon which to prioritize office space capital projects.

Current Monitoring Only Available through Commissioned Master Plans

In the 2019 legislative session, the Chair of the Assembly Way and Means Committee expressed a desire for a statewide strategic facilities plan to accompany consideration of CIP projects to add context to the Legislature's decisions.[7] A facility needs assessment is only available through commissioned master plan studies of various state-owned complexes. Master plans do not give policymakers an overall, continual picture of statewide office space needs. Instead, master plans are static, regional, and intermittent. The most recent commissioned Nevada master plans are:

- 1989 Capitol Complex Master Plan
- 2002 Capitol Complex Master Plan Update
- 2006 Las Vegas Master Plan
- 2009 Reno-Sparks-Rural Master Plan

The plans have not been updated since they were issued. Master plans are an integral part, but not a substitute for, a long-term facility needs plan.

Conclusion

State master plans are outdated and do not reflect the state's current or long-term facility needs. SPWD should require agencies to biennially submit updated long-term facility needs. A long-term facility needs plan is not possible without an on-going commitment from agencies to push base information into a process that compiles, analyzes, and reports results to decisionmakers. Requiring agencies to biennially submit updated long-term facility needs assessments will provide information to assist executive and legislative officers with capital improvement project decisions.

Recommendation

2. Require agencies to biennially submit updated long-term facility needs.

[7] Committee on Ways and Means and Senate Committee on Finance, April 23, 2019, Minute mark 1:05:40 – 1:07:04.

Identify Economical Consolidation Opportunities to Improve Efficiencies Reduce Reliance on Leases for Office Space Needs

The State Public Works Division (SPWD) should identify opportunities to improve efficiencies and reduce reliance on leases for office space needs when economical. Improving efficiencies and reducing reliance on leases for office space will ensure agencies are more productive, agencies are housed in facilities that support their missions, and the benefits of ownership accrue to the state over time.

SPWD does not regularly analyze statewide consolidation opportunities, only sporadically and regionally through master plan commissions. Other states analyze agency long-term facility needs plans to identify compatible cross-agency functions and geography to identify opportunities to consolidate facilities. With no requirement for agencies to report long-term facility needs plans, nor the assignment of tasks to analyze the information, no basis for analysis is available. Consolidation opportunities are not visible to executive and legislative branch officials to pursue.

Identifying agencies' compatible missions requires examination as important as cost factors. Maintaining and updating consolidation plans reduce reaction time when economic factors require a rapid response to realize estimated savings from consolidation. This is important with a biennial decision-making process. As stated in Oregon's Statewide Facilities Planning Process:

> ...it is important to understand that while each agency may (or may not) have existing strategic plans that identify future capital investment needs, there is currently no established process that integrates multiple agency plans in a manner that reveals strategic opportunities that optimize outcomes for the state and its citizens across agencies. These opportunities might include the shared (multi-agency) need for specialized facilities, such as labs or field offices; consolidating inadequate or expensive leased facilities into long-term, state-owned assets; and identification of strategic economic development opportunities in rural communities. This integrated, long-range view is important as the state considers how best to deliver services, provide the most responsive government, and leverage capital funds to optimize program delivery and maximize community impact...

Reliance on Leased Office Space is Increasing

Reliance on leased office is increasing over time, despite numerous master plans identifying transition to ownership as a key objective. Agency office space is scattered throughout the Carson City and Las Vegas metro areas, perhaps in space not optimally suited for agencies' missions. Moreover, the state's reliance on leases is not apparent in the context of the Capital Improvement Plan (CIP) review process. As the 2002 Capitol Complex Master Plan Update noted:

> ...A major variable in this assessment is the need to replace leased space with owned space. In addition, there is a recognition on the part of the Executive Branch of the state government that operational efficiencies could be achieved by co-locating like functions and consolidating certain departments which are presently located in numerous decentralized leased and owned facilities...

At the time the 2002 Capitol Complex Master Plan Update was published, there was 673,000sf of leased office space; today there is 717,000sf, a 6.5% increase. Monitoring statewide and regional reliance on leases to meet current and projected office space needs will be an important component of a long-term facility needs plan and useful in the CIP prioritization and selection process.

Capitol Complex and Bradley Government Campus Development Study Identified Savings

In March 2015, SPWD received the results of a study performed by a firm retained to provide underlying analysis of three buildings: two at the Capitol Complex in Carson City and another at the Bradley Government Campus in Las Vegas.[8] Each proposed building was 130,000sf, four floors of 32,500sf, cost $45 million, and built to a 50-year life-cycle standard.[9] The study contemplated the consolidation of Department of Health and Human Services (HHS) offices in the two Capitol Complex buildings and two options for the Bradley Complex building. One of the Bradley Complex options focused on consolidation of Department of Business & Industry (B&I) offices and the other consolidated a variety of other agencies.[10] The study estimated 2-5% operational efficiency improvements related to departmental consolidation of administrative functions for HHS and B&I. Each scenario was designed to fit the current office space footprint of the participating agencies and to coordinate occupancy with the expiration of existing leases.

The study explained the relative merits of various financing options: Lease-Purchase; Installment Purchase; Medium Term Financing; and, General Obligation Secured by Pledged Revenues. Under the Lease-Purchase arrangement, the analysis showed estimates of net savings to the state of $106 million - $115 million at year 30, with a residual building value of $54 million for the three buildings, depending on the chosen option.[11] See Exhibit IV for a comparison of lease-purchase savings.

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[8] Government Facilities Development Services was the retained firm.

[9] In 2015 dollars.

[10] The Department of Health and Human Services and the Department of Business & Industry are decentralized and have historically been identified as prime candidates for consolidation in master plan studies.

[11] A Lease-Lease Back structure permits the opportunity to use tax exempt bond financing, coupled with a Not-for-Profit borrower, to build facilities making the debt "non-recourse" to the Sate with minimal, if any, impact on future bonding capacity. Nevada Real Property Corporation was created in 1998 to facilitate this type of financing structure.

Exhibit IV

Lease-Purchase Estimated Savings

Lease-Purchase 30-Year Financing	Year 10 Estimated Savings	Year 30 Estimated Savings	Year 30 Residual Value of the Three Buildings
4 Year Interest Only	$5.66M	$106M	$54M
2 Year Interest Only	$3.21M	$111M	$54M
30 Year Fixed Term	$1.23M	$115M	$54M

Source: Options for the Development of the Capital Complex in Carson City and the Bradley Government Campus in Las Vegas, March 9, 2015 by Government Facilities Development Services.

Conclusion

SPWD should identify consolidation opportunities to reduce reliance on leases for office space needs. Nevada lacks an on-going process to identify economical consolidation opportunities that optimize the state's portfolio of owned and leased office space. Identifying economical consolidation opportunities to reduce reliance on leases for office space needs will improve efficiencies. Consolidation is a critical element of strategic planning for long-term facility needs. The long-term needs of agencies must be considered together in order to identify compatible missions with geographic suitability. Project scale is an important element when optimizing cost, and consolidation allows options of varying scale to be considered.

Recommendation

3. Identify economical consolidation opportunities to reduce reliance on leases for office needs.

Develop Lease-Purchase Models to Estimate the Cost of Long-Term Options

The State Public Works Division (SPWD) should work in alignment with the Department of Administration to develop an in-house lease-purchase model to estimate the cost of long-term options. Nevada does not have a lease-purchase tool available to conduct preliminary lease-purchase estimates. Developing lease-purchase models to estimate the cost of long-term options will identify potential savings to the state when prioritizing capital projects. Other states provide a lifecycle lease-purchase model that allows agencies to preliminarily estimate the cost of lease versus purchase options. Without an available estimation model, agency leadership lacks a tool to independently conduct an initial estimate.

Lease-Purchase Models Identify Investment Opportunities

Lease-purchase models can be used to identify investment opportunities and informed decisions. While Nevada doesn't utilize lease-purchase models to make long-term decisions, a number of surveyed states use these models to explore alternatives that may provide savings to the state. In Idaho, the Department of Administration, Division of Public Works is required to conduct a comprehensive analysis of facility needs, space utilization efficiency, long-term needs and objectives, and viable purchase alternatives. Idaho developed a lease-purchase model as a tool to determine whether it is more cost effective to lease or purchase buildings. The tool analyzes each lease and key inputs include: information about lease agreements; land and construction costs; operating and financing costs; and inflation assumptions.

The Oregon Department of Administrative Services adopted a model to provide an objective evaluation of long-term, strategic investment decisions. Each agency meeting criteria is required to submit an Agency Facility Plan (AFP) designed as a means of collecting information to satisfy statutory requirements. The AFP permits the Facilities Planning Unit and Capital Projects Advisory Board to evaluate agency projects and perform long-term strategic planning. Similar to Idaho, the Oregon model utilizes key inputs such as information about lease agreements, land and improvement costs, and operating and financing costs to perform the analysis.

Washington requires all proposed leased and owned property and acquisition projects greater than 20,000sf to be supported by a life-cycle cost analysis, unless expected occupancy is less than five years. Users can develop the analysis by providing basic information such as: existing lease information; proposed lease terms; location; square feet; construction or purchase costs; and project completion dates. The model allows most of the assumptions to be overridden by agency-supplied numbers although financial assumptions are provided by the Office of the Treasurer and cannot be changed by agencies.

Expertise Required to Analyze
Lease-Purchase Options

Other states assign the lease-purchase analysis function to experts in the financial management arena. If a special unit has been designated to perform long-term facility needs planning, the lease-purchase analysis is performed after agencies have specified their long-term facility needs. The analysis then accompanies the statewide long-term facility needs plan through the capital improvement project selection and prioritization process.

Lease-Purchase Models
Inform Leasing Terms

The lease-purchase models can be used as a tool to inform terms that are most financially advantageous to the state. The models used in the other states not only help determine the relative economic costs of various alternatives but provide a long-term analysis of lease-purchase decisions. For example, the Idaho model yields a cost ratio which can be used to determine whether it is more cost effective to lease or purchase. If the cost ratio is below 1.00, a facility purchase should be considered. If the cost ratio is a negative number, the lessor is subsidizing the lessee and is receiving less than the actual cost of operating a building.

Conclusion

A decision model is currently not available for state agencies to initiate a proposal for long-term office space needs outside of the lease renewal process. Developing lease-purchase models to estimate the cost of long-term options will identify potential savings to the state when prioritizing capital projects.

Recommendation

4. Develop lease-purchase models to estimate the cost of long-term options.

Incorporate Analysis of Long-Term Statewide Office Space Needs into the Capital Improvement Plan Reporting Structure

The State Public Works Division (SPWD) should incorporate analysis of long-term statewide office space needs into the Capital Improvement Plan (CIP) reporting structure. Nevada's CIP reporting process does not include a long-term office space needs assessment. Statute and regulations do not require such information to be compiled, analyzed, or reported through any channel, including the CIP process.

The CIP process would be the appropriate avenue to inform executive branch officials and legislators during the project prioritization and selection process. In Nevada, construction projects are prioritized and selected in isolation, without a strategic view or plan. As a result, opportunities may be overlooked, leaving commercially leased office space as the default option, rather than a deliberate decision based on informed facilities portfolio management. Legislators have expressed similar thoughts in recent legislative sessions.

Oregon, Washington, Idaho, and Utah require continual, long-term facilities needs assessments as an integral part of prioritizing and selecting their capital projects.

Other States have Reporting Mechanisms for Long-term Office Space Needs

Other states have reporting mechanisms that consider options to meet long-term office space needs. For capital projects related to office space needs to be considered in the proper context, decisionmakers need analysis to support their decisions. In the other states, units within the equivalent of Nevada's Department of Administration provide the contextual analysis:

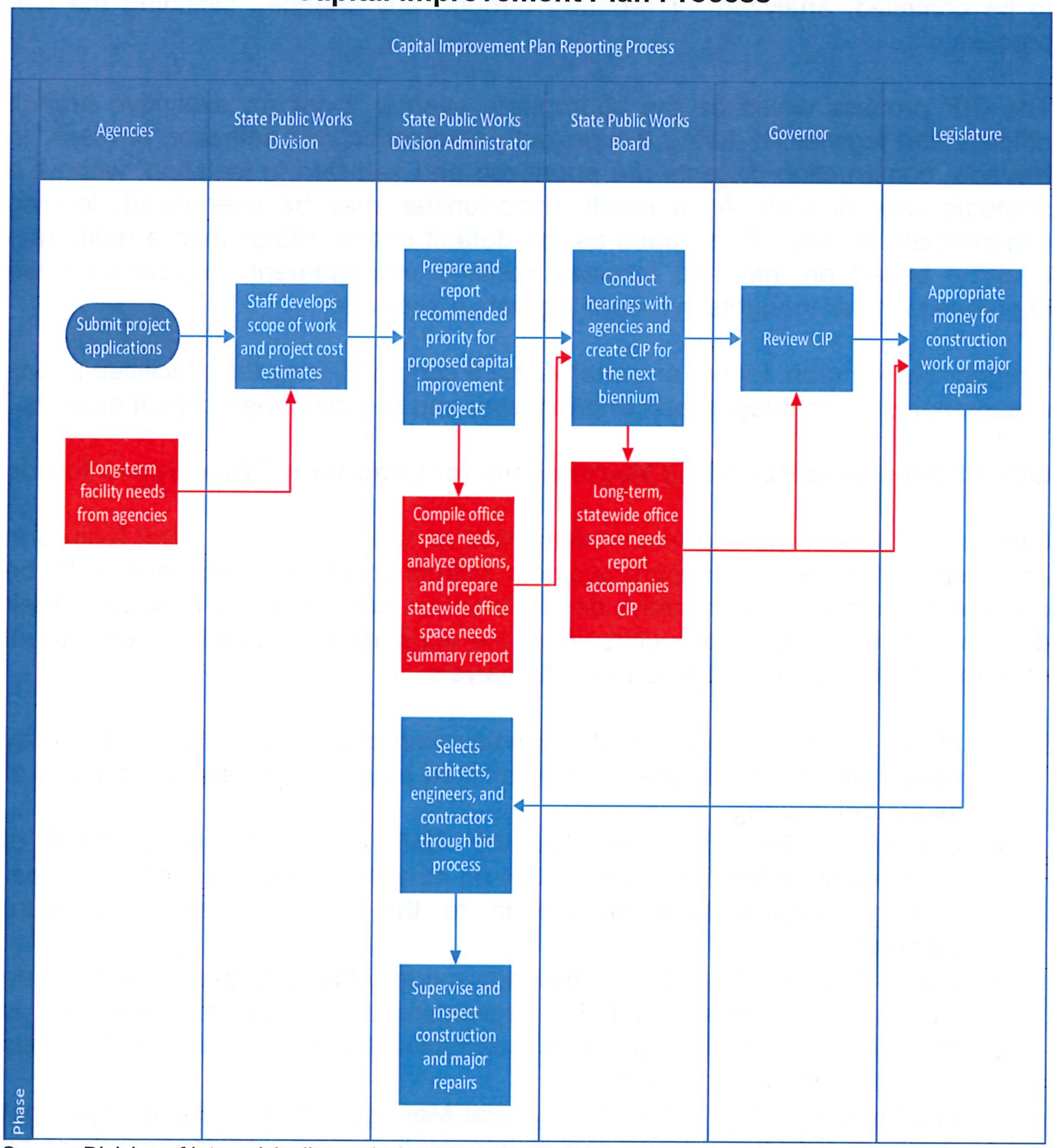
- Idaho – The Department of Administration prepares a statewide facility needs plan based on agencies' submitted plans and presents biennially at its budget hearing.
- Oregon – The Facilities Planning Unit within the Department of Administrative Services, assisted by an advisory board, presents a 10-year Strategic Capital Investment Plan to the Governor and Legislature biennially.
- Utah – The Utah State Building Board annually presents the 5-year building plan to the Governor and the Legislature after input from agencies is compiled; economic analysis is conducted by the Division of Facilities Construction Management.
- Washington – The Office of Financial Management's Facilities Oversight Program (FOP) oversees real estate procurement and management by applying a statewide perspective to analysis, long-term planning, policy development, and state facility portfolio management. The FOP develops and submits a Six-Year Facilities Plan to the Legislature and the Governor biennially with the assistance of the Department of Enterprise Services.

Nevada's Capital Improvement Plan Lacks Long-term Statewide Office Space Analysis

Nevada's Capital Improvement Plan process lacks long-term, statewide office space analysis. See Exhibit V.

Exhibit V

Capital Improvement Plan Process



Source: Division of Internal Audits analysis of State Public Works Division's CIP process.
Note: Red call-outs are missing from the process.

A long-term, statewide facilities needs summary report to accompany the CIP would provide context to legislators by including such information as:

- Leased versus owned analysis - by agency, in total, historical, and prospective;
- Aging of owned office space buildings;
- Aging of lease expirations - by agency, in total, and superimposed over aging of owned space; and
- Supporting life-cycle cost analysis for lease-buy options.

Conclusion

Nevada lacks a reporting mechanism for a long-term, statewide facilities needs assessment, which fails to provide full context to decisionmakers in the building projects prioritization and selection process. SPWD should incorporate analysis of statewide office space needs into the CIP reporting structure. Incorporating analysis of long-term statewide office space needs into the CIP reporting structure will provide executive branch officials and legislators needed context and supporting analysis as they contemplate CIP projects and consider lease versus own decisions with a long-term view.

Recommendation

5. Incorporate analysis of long-term statewide office space needs into the Capital Improvement Plan reporting structure.

Appendix A

Scope and Methodology, Background, Acknowledgements

Scope and Methodology

We began the audit in March 2020. In the course of our work, we interviewed State Public Works Division (SPWD) staff and discussed processes inherent to SPWD's responsibilities. We reviewed SPWD records, applicable NRS, NAC, SAM sections, and surveyed other states' best practices. Additionally, we reviewed applicable reports, audits, and independent analyses. We concluded fieldwork in May 2020.

We conducted our audit in conformance with the *International Standards for the Professional Practice of Internal Auditing.*

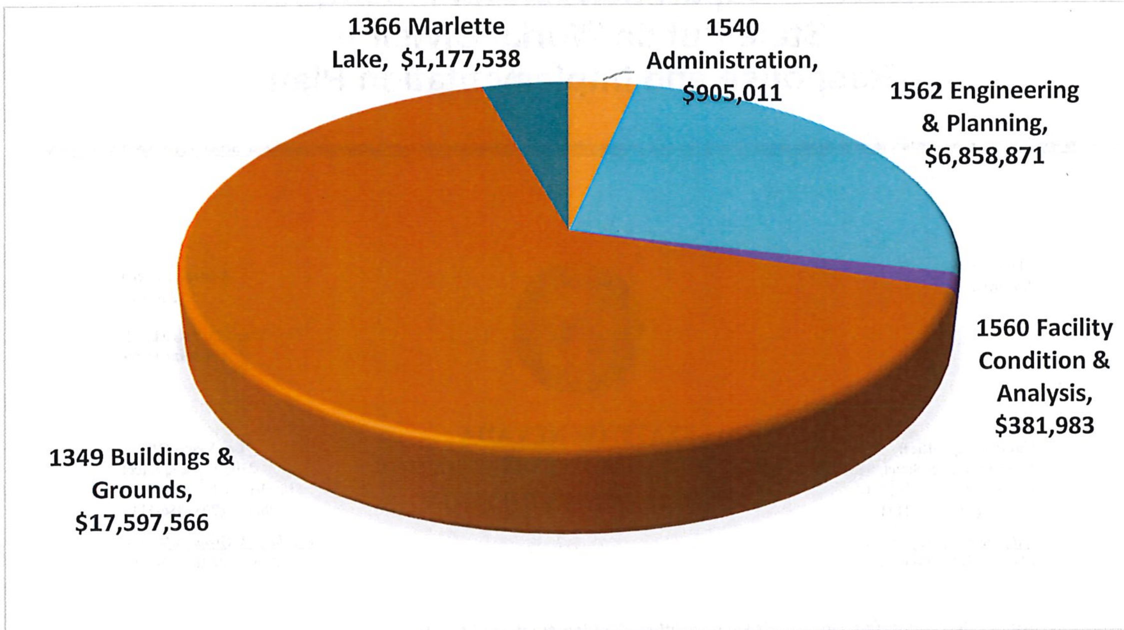
Background

The State Public Works Division's mission is to provide well planned, efficient, and safe facilities to state agencies so they can effectively administer their programs. SPWD operates through five budget accounts (BA): BA 1540 Administration; BA 1562 Engineering & Planning; BA 1560 Facilities Condition & Analysis; BA 1349 Buildings and Grounds Section (B&G); and BA 1366 Marlette Lake. Leasing Services is contained within B&G. B&G provides physical buildings and grounds maintenance and housekeeping for most state-owned buildings in Carson City, Reno, and Las Vegas. Leasing Services provides office space for agencies in state-owned buildings, and when not available, locates and negotiates leases in privately owned buildings through Leasing Services. SPWD provides professional engineering services related to permitting, inspection, and oversight of construction and maintenance projects. Additionally, SPWD provides administrative oversight of the Marlette Lake Water System.

SPWD's legislatively approved revenues for fiscal year 2020 is $26.9 million with 119 positions. Exhibit VI summarizes SPWD revenue by budget account for fiscal year 2020.

Exhibit VI

State Public Works Division – Revenue by Budget Account
Fiscal Year 2020



Source: Fiscal Year 2020 Legislatively Approved Budget.

Acknowledgments

We express appreciation to the State Public Works Division Administrator, Construction Law Counsel/Deputy Attorney General, Deputy Administrator – Buildings and Grounds, Leasing Services Manager, and staff for their cooperation and assistance throughout the audit.

Contributors to this report included:

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Appendix B

Nevada Department of Administration
State Public Works Division
Response and Implementation Plan

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STATE OF NEVADA
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To: Jeff Landerfelt, Governor's Finance Office, Division of Internal Audits

From: Ward Patrick, State Public Works Division Ward D. Patrick

Date: June 12, 2020

Re: Response to Audit

Thank you for the State Public Works Division's (SPWD) final report of the Division of Internal Audits' findings regarding State Public Works Division Long-term Office Space Planning. SPWD would like to commend your staff as they were thoughtful, thorough and professional throughout the entire audit process. SPWD appreciates the opportunity to respond to your recommendations and we look forward to working with the Division of Internal Audits on implementation.

Introduction

Before addressing the implementation of the audit's recommendations, it is appropriate to provide an overview of SPWD's project delivery process. This overview provides valuable context when considering the audit recommendations.

NRS 341.083(2) requires that the CIP recommendation "to the extent practicable, provide that each project which exceeds a cost of $10,000,000 be scheduled to receive funding for design and planning during one biennium and funding for construction in the subsequent biennium." Consistent with this requirement, larger projects take a minimum of 4 years to complete; projects are designed in one biennium and begin construction in the next.

PROJECT DELIVERY

Design Project Milestones

NRS 341.083 (2) requires that the State Public Works Board "submit [to the Governor] before October 1 of each even-numbered year its recommendations for projects for capital improvements in the next biennium."

The CIP effort begins as early as December, when 'lessons learned' from the prior CIP are incorporated into the CIP estimating process. As part of the proactive CIP, projects that were not approved in the prior session are reviewed with the Agency for possible resubmittal. In February of even-numbered years SPWD activates the webpage for Agency CIP requests.

- SPWD CIP – Due diligence [1]
  - Agency requests – Agencies submit a CIP application
    - SPWD Project Managers – (Last biennium SPWD received 750 CIP project requests with a total estimated project cost of $1.5 billion. Approximately 20 Project Managers conduct due diligence on each project request over an 8-week period. Each project receives approximately 10 hours of effort). SPWD employs Project Managers with broad experience across multi- disciplines, such as structural, mechanical, architectural, electrical, civil, ADA, paving, air quality, demolition and roofing. When developing CIP projects, SPWD employs a team approach utilizing all project manager specialized expertise.
    - Each CIP project requires –
      - Site visits
      - Development of project narratives and estimates[2]
      - Review record drawings (existing buildings)
      - Follow thirteen-page cost estimating instructions
      - Peer review (Jury review)
      - Develop conceptual designs
      - Prioritize projects
      - Agency meetings to build consensus on project scope and prioritization
  - Planning Project – Estimate (how created/effort) –
    - SPWD project managers due diligence – Planning Project
      - A Planning Project creates a budget for Project Design (the cost to design a building).
      - The Project description is typically "programming through construction documents for an xxxx square foot building." [3]
      - The basis for the project cost depends on a construction estimate for the building. This construction estimate is prepared as follows –
        - Agency meetings
        - Overview of program needs (10,000-foot level)
        - Site visits if appropriate
        - Estimates for plan check and utility design are included
      - Jury reviews – All projects are subject to peer reviews
        - The entire month of June is devoted to Jury reviews
        - Project Managers meet on every project with the Deputy Administrator, Chief of Planning, FCA Section, and Project Manager with a relevant expertise and defend all project assumptions
      - Administrator meets with every Agency to discuss selected projects, priorities and other relevant considerations to project selection

  - Construction Project- Total Project Cost (how created/effort)

[1] This largely in-house planning effort is performed by Project Managers in addition to their obligations managing ongoing projects in various levels of design, construction, warranty review and project close-out.
[2] SPWD's CIP planning effort is supported by Project #S04 – Statewide Advance Planning, which is used in part to support development of the CIP. This project has historically been funded between approximately $100,000 and $200,000.
[3] Other projects include: roofing, ADA upgrades, fire and life safety improvements, paving, environmental, energy retrofits, electrical, mechanical, structural, architectural renovations, civil, demolition and others.

        - Design effort – creates estimated cost of construction and other project costs (see detailed process below)
    - Management review of each project, including costs, scope and agency operations implications
    - Board presentations – Over a two day meeting, Agencies present their projects to the State Public Works Board [4]
    - Board Recommendation to the Governor – recommended projects based upon the following factors –
        - projects necessary to meet legal requirements
        - critical projects to 24-hour occupied facilities
        - Bonding capacity
        - Deferred maintenance needs
        - Status of prior projects
    - Governor's Recommendation to Legislature
    - Legislative Session
    - Approved CIP Bill (July of odd-numbered years)
- Implementation of Planning Project
    - For projects over $250,000 SPWD issues an RFQ and consultants are formally selected based upon qualifications (subsequent RFP includes authorized scope and construction budget)
    - Consultant (Architect/Engineer) hired to design xxxx square foot building for a fee
    - Contract documents – The Professional Services Agreement requires the following deliverables: programming (including an engineering report and structural calculations), schematic design, design documents, and 50% and 100% construction documents (ready for bidding). Each level of design results in a more accurate cost estimate (with the bid being the most accurate estimate). This effort begins with the SPWD predesign estimate, which per the American Society of Professional Engineers (ASPE) necessarily provides the lowest level of cost estimating accuracy. At each level of design unknowns are reduced, resulting in a more precise cost estimate.
        - The Professional Service Agreement also requires that the consultant provide a cost estimate at each design phase deliverable. The cost estimate must include a variance analysis from the previous cost estimate explaining any change in cost, scope and inflation
        - SPWD and Agency must approve the design and cost variance report at each phase, before the consultant is paid and approved to move on to next design phase
    - Design Presentations - Consultant, Sub-consultants, specialty consultants, cost estimators, CMARs, SPWD and Agency attend a presentation of each design phase deliverable (typically a 4 to 6 hour effort)
        - Original scope confirmed (minimizing scope changes, creating cost containment and inflation management)
        - Schedule reviewed and adjusted (unrealistic schedule may lead to unnecessary inflation or increased risks of costs and errors)
        - Manage design and costs
            - Architectural features
            - Engineering Systems
            - Building size (with legislative approval if required)
                - Agency expectations documented
                - Cost variance analysis reviewed and accepted
        - Peer review (all disciplines)

[4] Pursuant to NRS 341.020, six Board members must have construction experience and are appointed by the Governor, the Speaker of the House, and the Senate Majority Leader. The final Board member is the Governor appointed Director of the Department of Administration.

        - Plan Check
        - Commissioning – Begins at design development (See page 6, Construction Commissioning)
    - Regulatory Body requirements – State Historical Preservation Office, local utilities and zoning laws, State Fire Marshal, NV Energy, Federal Funding, other Grant Funding, local government, and health care facility certifying agencies.
    - The design effort (especially for renovations of existing spaces) is to reduce the occurrence of unknown conditions
    - SPWD due diligence is an ongoing effort throughout the project development process
- Final deliverable – Construction Documents/Bid documents with a construction budget (ready for bid)
    - If Bids exceed construction budget Professional Services Agreement requires consultant to
        - revise bid documents at no charge if bids exceed construction budget (beyond statutory limits allowing negotiation)
        - revise bid documents to conform to permissible negotiated revisions
    - If the lowest bid is less than 85% of the construction budget; the consultant fee may be adjusted downward
- CMAR Pre-Construction ends with the delivery and acceptance of a Guaranteed Maximum Price (GMP) Proposal for construction.

This emphasis on an accurate and sufficient project budget recognizes the critical importance of bids coming in within budget. If a project has to be rebid, it can cause significant delay, reduce the quality or quantity of key project elements and subjects the project to the risk of inflation/escalation impacting the Program the project was intended to serve.

Construction Project Milestones

SPWD begins the CIP process again. Generally, the planning project approved in the prior biennium is submitted as a construction project with a construction budget based upon design development documents for the building. The basis of the CIP estimate will be design at approximately 50% typically described in the Project Cost Estimate as "This project is a continuation of Planning project xx; construction of an approximately xxxx square foot building."

In addition to the construction cost estimate, the CIP Project presented as a construction project in the second biennium now includes the total project cost estimate which now includes construction contingency, professional services for design and supervision, FF&E, project management and inspections fees etc.

Bidding – As noted the Professional Services Agreement requires the consultant to adjust the bid documents at no charge if the bids exceed the construction budget.

With this background and the CIP Project TimeLine in mind State Public Works Division submits the following response to the Audit Recommendations:

Recommendation #1: Propose Legislation to Implement and Maintain a Statewide, Long-term Office Space Needs Assessment.

SPWD understands and accepts the audit recommendation. SPWD will propose legislation to require a Statewide, Long-term office needs assessment and the additional staff to support the effort in 2023 or as funding becomes available.

Currently, SPWD is obligated to "cooperate with other departments and agencies of the State in their planning efforts." (NRS 341.127) SPWD is also obligated to "periodically inspect [and report all findings and recommendations] on all buildings owned by the State..." (NRS 341.128) Both of these statutes could be amended to add this requirement. SPWD also recommends that the requirement be added to each agencies' enabling legislation to further assure agency compliance. Of course, this will add new obligations to executive agencies that they currently do not perform.

SPWD's Facility Condition Analysis group is currently comprised of 3 positions. SPWD will propose legislation to require a Statewide, Long-term office needs assessment and the additional staff to support the effort in 2023 or as funding becomes available.

Recommendation #2: Require Agencies to Biennially Submit Updated Long-Term Facility Needs Assessments.

SPWD understands and accepts the audit recommendation. SPWD will propose legislation and additional staff to support the effort in 2023 or as funding becomes available.

During the CIP development, SPWD consults extensively with each agency and/or department regarding their "long term facility needs" and utilizes the Facility Condition Analysis (FCA) to ascertain a facilities' physical condition needs. There is no "statewide" assessment.

As noted above, SPWD proposes adding legislation in each agencies' enabling statutes requiring their submittal of facility office space needs. Proposed legislation would include a definition of "long-term" and assist with agency compliance. SPWD understands that agencies currently provide the number of people, and square footage into the Nevada Execute Budget System (NEBS). This may be a sufficient as a starting point. However, agencies do not possess the expertise to perform a useful analysis of this data.

SPWD currently utilizes professionals for facility/office needs 'assessments.' Any analysis of this information for planning purposes requires professional input. For example, SPWD retained an architect firm and utilized a SPWD Project Manager (licensed architect) to survey and interview Grant Sawyer Office Building occupants to determine occupants' long-term needs. (Approved in 2018, Project 17-S04 $600,000) This formal effort to develop the facility needs for the Grant Sawyer Building occupants was used to support and obtain approval for Project 19-P01 (Advance Planning Grant Sawyer Office Building Remodel).

SPWD also utilizes Master Plans for the State's various geographical areas and to access various agency needs. These Master Plans and Programs assess land use, adjacencies, program and facility needs etc. Some relate more to programming needs, but all are related to office needs to meet staffing needs. These program and Master Plans are also relevant in illustrating the overall needs of the State.[5] The current 2019 CIP includes Project 19-S04 the Updated Master Plan for the Capitol Complex, as the last one was completed in 2002. The preparation of the 2002 Capitol Complex Master Plan surveyed 109 agencies. While this Master Plan is eighteen years old, much of the information is still relevant and unchanged.

SPWD will propose legislation and additional staff to support the effort in 2023 or as funding becomes available.

Recommendation #3: Identify Economical Consolidation Opportunities to Reduce Reliance on Leases for Office Space Needs.

SPWD understands and accepts the audit recommendation. SPWD will request authority to purchase a software system and additional staff to support this effort in 2023 or as funding allows.

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[5] Northern Nevada Adult Mental Health Services Campus Master Plan; Stewart Master Plan; Government Facilities Development Services – Business and Industry Consolidation; Bryan Building Program; EICON Building Program; NDOC Facilities Master Plan; Administration Building Capitol Complex Master Plan; and Grant Sawyer Tower Program.

First, NRS 331 requires SPWD's Buildings & Grounds Section to utilize State-owned space first. Only when the appropriate State-owned space is not available does B&G locate commercial office space to serve agency needs. Thus, consolidation within State-owned space occurs to the extent possible.

If there is an opportunity for an agency to collocate in existing space either leased or state-owned, that decision to collocate would not be part of the CIP. An initial screening would determine that agency needs could be met in existing space – either state-owned or leased space, and outside the CIP.

Second, SPWD has proposed numerous planning projects for inclusion in the CIP that recognize that value of Department agencies collocating. For example, Department of Public Safety and Department of Health and Human Services. These projects were proposed utilizing the agencies long-term needs and processed through the CIP due diligence noted above.

There are real estate management software programs that can track all state-owned and leased space with specificity such that all employee locations and furniture can be tracked and noted. Long term lease expiration dates, adjacency needs, vacancies, space needs and are all coordinated and tracked. Reports generated from this inventory could be reported to the Legislature and Executive Branch as justification for the CIP requests.

SPWD will request authority to purchase a software system and additional staff to support this effort in 2023 or as funding becomes available.

Recommendation #4: Recommend Lease-Purchase Models to Estimate the Cost of Long-Term Options

SPWD understands and accepts the audit recommendation. SPWD will request staff to support this effort in 2023.

Recommendation #5: Incorporate Summary Analysis of Statewide Office Space Needs into the Capital Improvement Plan Reporting Structure

SPWD understands and accepts the audit recommendation. SPWD will request staff to support this effort in 2023 or as funding becomes available.

As noted above, SPWD proposes that office space needs be implemented in coordination with the preparation of the FCA. Currently under Exhibit V, the audit recommends that SPWD's assessment of 'long term facility plans' would occur during the CIP development. Development of the CIP is SPWD's largest effort, therefore, SPWD recommends that long term facility plans be developed and known prior to the CIP development. If agency long term facility needs are assessed and known prior to CIP development, this information can be fully utilized in developing a CIP project. [6]

The 'long term statewide facilities plan' would be provided to the GFO and LCB as supporting justification when relevant to a CIP request.

SPWD will request staff to support this effort in 2023, or as funding becomes available.

[6] SPWD does not oversee NDOT, NSHE or the Legislature's buildings. SPWD does however, implement CIPs for NSHE and over 100 other state agencies.

Appendix C

Timetable for Implementing Audit Recommendations

In consultation with the State Public Works Division (SPWD), the Division of Internal Audits categorized the recommendations contained within this report into two separate implementation time frames (i.e., *Category 1* – less than six months; *Category 2* – more than six months). SPWD should begin taking steps to implement all recommendations as soon as possible. SPWD target completion dates are incorporated from Appendix B.

Category 1: Recommendations with an anticipated implementation period less than six months.

Recommendations	Time Frame
1. Propose legislation to implement and maintain a long-term statewide office space needs assessment. (page 2)	July 2023
2. Require state agencies to biennially submit updated long-term facility needs. (page 7)	July 2023
3. Identify consolidation opportunities to reduce reliance on leases for office space needs. (page 9)	July 2023
4. Develop lease-purchase models to estimate the cost of long-term office space options. (page 12)	July 2023
5. Incorporate analysis of long-term statewide office space needs into the Capital Improvement Plan reporting structure. (page 14)	July 2023

The Division of Internal Audits shall evaluate the action taken by SPWD concerning the report recommendations within six months from the issuance of this report. The Division of Internal Audits must report the results of its evaluation to the Executive Branch Audit Committee and SPWD.