



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

**Audit Report**

**State Public Works Division  
Leasing Services  
Commercially Leased Office Space**

DIA Report No. 20-02  
November 7, 2019



**EXECUTIVE SUMMARY**  
**Department of Administration**  
**State Public Works Division, Leasing Services**

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**Objective: Minimize the Costs of Commercially Leased Office Space**

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**Ensure Negotiated Rates for Commercial Office Space Reflect the Strength of the State’s Bargaining Position**..... page 2

Maximizing the state’s negotiating leverage would yield an estimated \$2.8 million in reduced leasing costs. The state’s negotiating position is bolstered by attributes that offer assurances to lessors: strong credit standing; ability to occupy large blocks of office space; tenants that are screened, trained, and closely managed; quarterly prepayments of rent; and a dedicated staff for lease dispute resolution.

Leasing Services can ensure negotiated rates reflect the strength of the state’s negotiating position by extending the timeline requirement for space requests to allow adequate time to pursue alternative locations without compromising bargaining leverage. Consulting the GFO Budget Division when agencies are reluctant to consider cost-effective alternatives will provide objective third-party input to resolve issues in favor of the state’s interest. Enhancing staff qualifications will provide needed oversight and day-to-day operational assurance.

Accessing dynamic market data through the Multiple Listing Service will provide more accurate information to determine fair rates during the negotiating process. Publicizing office space needs will generate competitive interests, broaden opportunities for building owners while increasing options for alternative locations. Monitoring interim term increases will help ensure rates stay within the desired market range throughout the lease term. Disclosing the rate effect of tenant-requested improvement costs will provide transparency during the review and approval process to ensure requested improvements are not over-recovered by the lessor during the lease term.

**Develop a Method to Ensure All Available State Office Space Options Are Considered**..... page 15

Developing a method to consider all available state office space options before engaging in commercial leases will ensure the state avoids unnecessary commercial office leases. Statute requires two inventories be reported annually to the SPWD Administrator to assist with filling available state office space before engaging in commercial office leases. The first inventory pertains to leased space, applies to all agencies, and requires each agency to identify the location, size, and current use of leased real property. This inventory is not being reported as required. The second inventory pertains to state-owned real property and applies to three agencies: Nevada Department of Transportation, Division of State Lands, and State Public Works Division. Like the leased property inventory, this inventory requires each agency to identify the location, size, and current use of state-owned real property. This inventory is reported but the information provided does not identify available office space; it is not helpful to the administrator in identifying available state-owned office space options. Because the inventories provide the basis of information needed for the statutorily required website posting by the administrator, it is imperative

that agencies understand what information needs to be reported. SPWD should clarify, in regulation, the information and format needed to identify office space opportunities. Fully utilizing available state office space resources will help ensure commercial office lease costs are minimized.

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# INTRODUCTION

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At the direction of the Executive Branch Audit Committee, we conducted an audit of the State Public Works Division (SPWD), Buildings and Grounds Section (B&G), Leasing Services. Our audit focused on SPWD's administration of leasing activities. The audit's scope and methodology, background, and acknowledgements are included in Appendix A.

Our audit objective was to develop recommendations to:

- ✓ Minimize the cost of commercially leased office space.

## **Building and Grounds Section, Leasing Services Response and Implementation Plan**

We provided draft copies of this report to SPWD for its review and comments. 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 our 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. 20-02) contains our *findings, conclusions, and recommendations*.

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## **Minimize the Cost of Commercially Leased Office Space**

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The State Public Works Division (SPWD), Buildings and Grounds Section (B&G), Leasing Services can minimize the cost of commercially leased office space by:

- Ensuring negotiated rates for commercial office space reflect the strength of the state's bargaining position; and
- Developing a method to ensure all available state office space options are considered.

Minimizing the cost of commercially leased office space occupied by Executive Branch agencies will benefit Nevadans by increasing funds for other programs.

### ***Ensure Negotiated Rates for Commercial Office Space Reflect the Strength of the State's Bargaining Position***

Leasing Services should ensure negotiated rates for commercial office space reflect the strength of the state's bargaining position by:

- Increasing the timeline requirement for agencies to submit space requests;
- Ensuring staff have access to the best market information;
- Providing adequate staffing;
- Publicizing office space needs;
- Monitoring interim term increases; and
- Documenting the monetary value of tenant-requested improvements.

Ensuring negotiated rates for commercial office space reflect the strength of the state's negotiating position could benefit Nevadans an estimated \$2.8 million annually.

### **Timeline for Lease Renewals Is Not Adequate**

Increasing the timeline requirement for agencies to submit space requests would allow Leasing Services to consider office space alternatives and allow more time to negotiate better lease rates. Alternative space options would include moving an agency into available state-owned office space or other leased space in the area. A twelve-month timeframe would allow Leasing Services to consult with the agency and fully explore all office space options available. Currently, Leasing Services requests three months advance notice from agencies for renewals and relocations

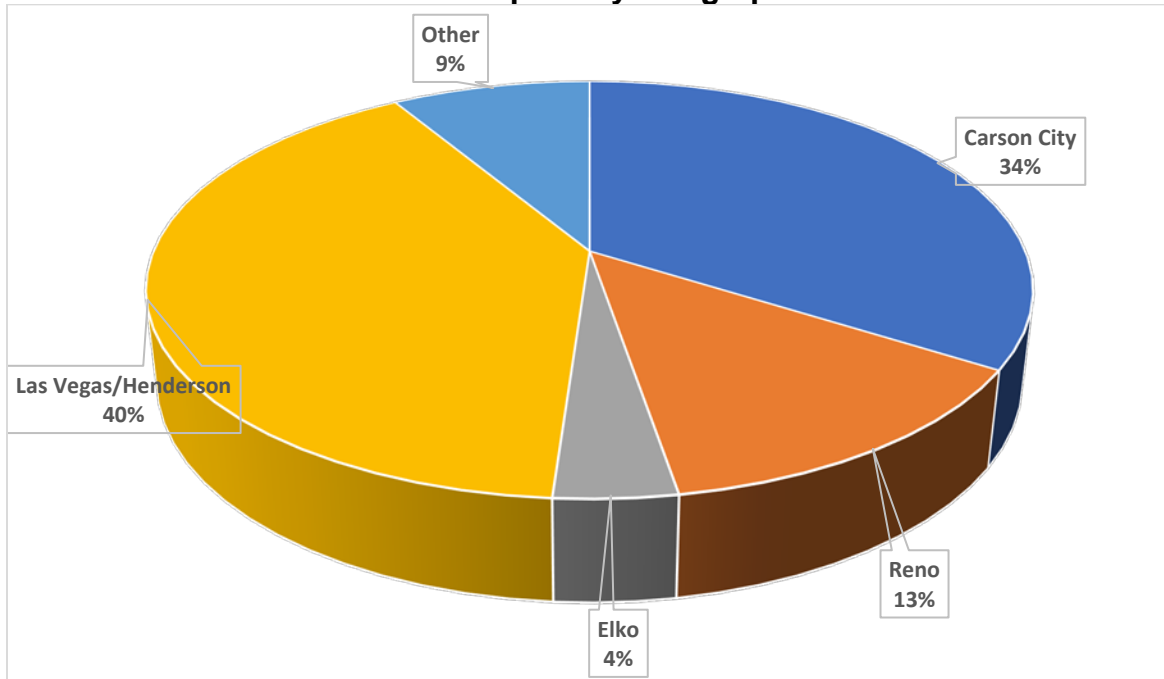
that anticipate only minor improvements and nine months for agencies considering renewals or relocations anticipating major renovations to create suitable space.<sup>1, 2</sup>

Statute requires state agencies to submit office space needs to Leasing Services. Leasing Services acts as the negotiating agent and official lessee for state commercial lease contracts with the agency as the tenant. Per SPWD, statute allows exemptions from this requirement for the Nevada System of Higher Education (NSHE), Department of Corrections (NDOC), and Title 54 licensing boards. Boards may choose to use Leasing Services.

Leasing Services manages 329 commercial leases, 291 of which are exclusively for office space. These leases amount to 2.1 million square feet (67%) of the state's 3.2 million square feet of office space.<sup>3</sup> Collectively, the 291 office leases represent approximately \$41 million of annual commitments funded by client agencies. See Exhibit I for a breakout of leased space by geographic area.

**Exhibit I**

**Leased Office Space by Geographic Area**



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

<sup>1</sup> Revised Proposed Regulations LCB File No. R077-17, dated December 19, 2018, paragraph 4.  
<sup>2</sup> Minor improvements are not considered an imposition to staff, such as balancing room temperature or phased upgrading of bathrooms.  
<sup>3</sup> Does not include office space of Nevada System of Higher Education or Nevada Department of Corrections.

We reviewed 31 lease files representing 46% of leased office space and 48% of lease costs. We found agencies met the timeframe established by Leasing Services with only two (6%) going into “holdover” status.<sup>4</sup> However, the established timeline may not be adequate from a negotiating standpoint. The timeframe should be sufficient to allow alternatives to be fully explored, even for renewals with minor improvements, and executed in the event favorable options arise.

Twenty-eight out of 31 leases (91%) reviewed were renewals. Lease renewal terms ranged from three years to 10 years, with an average term of 87 months. On average, lease rates increased by 3.6% with each renewal.<sup>5</sup>

Agencies initiate the commercial lease process by submitting Space Request and Space Justification forms to Leasing Services. Leasing Services notifies agencies six months before lease expiration that Space Request forms are due.

Leasing Services tours the facility and notes maintenance, renovation, and modified space issues to be discussed during the negotiation process with the owner or property manager. Leasing Services researches market rates by reviewing current listings and market data, then contacts the owner to begin negotiations.

Once the terms of the contract are agreed upon, Leasing Services prepares the Lease Agreement, Statewide Lease Summary and exhibits for review and approval by the tenant, lessor, SPWD Construction Law Counsel and Administrator. Once obtained, the leasing packet is prepared for GFO Budget Division review and Board of Examiners (BOE) approval. Upon approval, copies of the lease agreement are distributed by Leasing Services to all parties.<sup>6</sup> See Exhibit II for the commercial lease process.

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<sup>4</sup> A “holdover” results when the lease moves into a month-to-month arrangement after expiration of a lease term. “Holdover” provisions are stated in the lease agreement allowing month-to-month arrangements at elevated lease rates, usually 5% for a stated period, then increasing thereafter.

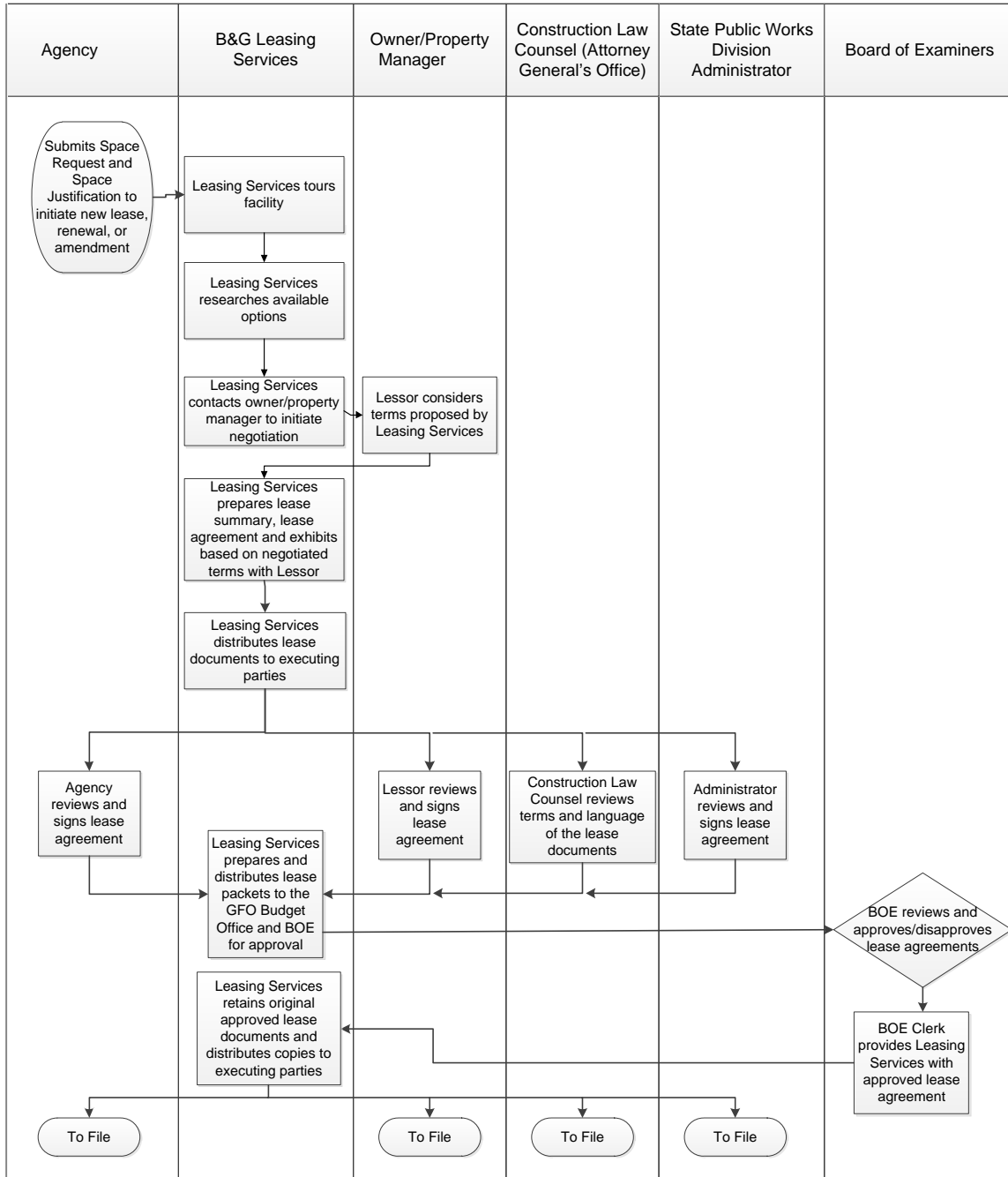
<sup>5</sup> This calculation is based on weighted average negotiated rates between prior and current leases for 21 of 31 files reviewed that had cost/benefit analyses performed. The current negotiated rates ranged from a decrease of -18.8% to an increase of 27.1% over the prior negotiated rate.

<sup>6</sup> Lessor (Owner), Lessee (SPWD), and Tenant (Agency)



**Exhibit II**

**Commercial Lease Process**



Source: State Public Works Division – Leasing Services, Procedures Desk Manual

The process described above must take place within the three-month window. This short timeframe does not allow the agency or Leasing Services to explore alternative leasing options. Further, the short timeframe diminishes the state's negotiation leverage because an agency does not have time to find less expensive

space, gain required approvals, make tenant improvements, and move before the lease expires. A twelve-month timeframe would allow Leasing Services and the agency to plan for the agency's space needs, search for available state-owned properties or alternative lease space, and negotiate with the current landlord for the best possible lease rate. At three-months, the existing location can become the only viable option due to time constraints causing the state's negotiating position to be compromised.

We reached out to one client agency that recently contracted for new office space in Reno. This client self-initiated the process through Leasing Services nine months before the expiration of its existing lease. The existing lease did move into "holdover" status despite all parties proceeding as quickly as possible in good faith. The client noted that a six-month timeframe would have been "impossible" due to advance scheduling requirements for EITS infrastructure renovations and BOE. The client noted that, in retrospect, beginning one-year in advance of lease expiration should be the standard.

### **Ultimate Lease Decision Rests with the Agency**

The SPWD Administrator has the exclusive authority to contract for commercial office space on behalf of state agencies. Currently, Leasing Services serves client agencies by locating suitable options and negotiating a reasonable rate, but ultimately the decision to renew or relocate rests with the client agency. Staff stated during our review that agencies may be reluctant to relocate, even when cost effective alternatives exist. One reason agencies resist is because the budget cycle has not yet vetted and approved associated moving and other transition costs. This process can result in forgone opportunities for cost savings to the state.

The GFO Budget Division is in a position to determine whether a renewal or relocation is in the state's best interest. The GFO Budget Division can intervene and make the final determination when a cost-effective alternative is available but a client agency resists pursuing options provided by Leasing Services.

### **Leasing Rates Do Not Reflect the State's Strong Negotiating Position**

Negotiating with the state offers certain assurances to the lessor that are not universally available in the private sector. Among these assurances are the state's:

- Creditworthiness;
- Ability to occupy large blocks of office space;
- Tenants that are screened, trained, and closely managed;
- Quarterly prepayments of rent; and,
- Dedicated staff for lease dispute resolution.

Leasing Services' negotiating position is strong and should translate to negotiated rates at the low end of the market rate spectrum. Surveyed states characterized their negotiating position as "strong."<sup>7</sup> Utah and Oregon stated generally the state should not pay market rates and they strive for about 95 percent of market rates.

Transforming these unique attributes into negotiating leverage requires access to the best available market data, timely consideration of available options, generating a pool of competitive interests, conservative interim rate increases, and transparent itemization of rate components.

### **Staff Do Not Have Access to Best Available Market Information**

Discussions with staff, conclusions from state surveys, and analysis of market data indicate staff lacks data essential to negotiating better rates. Ensuring control, monitoring, and negotiations commensurate with a process that generates approximately \$40 million per year in budgetary commitments requires additional resources.

### Retrospective Performance Analysis Methodology Not Sound

Leasing Services performs a retrospective performance analysis annually. In this analysis, they compare negotiated rates to the average market rate. The average market rate is derived by averaging closed transactions and active listings published from a variety of sources for each of the four major market areas.<sup>8</sup> Each source provides a range-low and range-high. An average low and average high are calculated for both the closed transactions and active listings, which are then averaged to determine the market average for the region. The regional averages are then averaged and weighted by square footage to derive the statewide average market rate.

Leasing Services' annual retrospective market analysis, summarized in Exhibit III, shows the active leases in fiscal year 2018 reflecting a statewide negotiated rate about 9% below the average market rate:

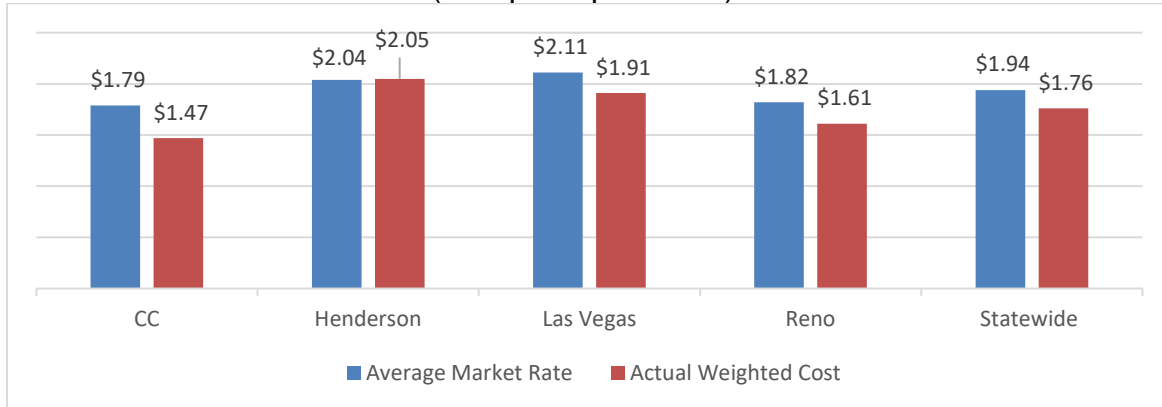
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<sup>7</sup> Arizona, Idaho, Oregon and Utah.

<sup>8</sup> **Carson City:** CoStar, Loopnet, Carson Properties, Logic, Mallard, NAI Alliance, SVN, & Uhart. **Henderson:** Avison Young, Loopnet, Coldwell Banker, Cushman & Wakefield, Logic, MDL Group, Newmark, Priority One, Real Capital, Sansome, SVN, Sun Commercial & Virtus. **Las Vegas:** Avison Young, CBRE, Colliers, Newmark, Lied/UNLV Study, Loopnet, Logic, Perry Guest, RAM, RealNex, Sanone, SVN, Sun Commercial, Thomas & Mack & Tiberti. **Reno:** CBRE Colliers, CoStar, Loopnet, ArchCrest, Avison Young, DGC, Lee & Associates, Logic, RM&D, Stark, SVN.

### Exhibit III

#### Negotiated vs. Average Market Rates per Leasing Services (cost per square foot)



Source: Leasing Services' 2018-19 Market Analysis Workbook

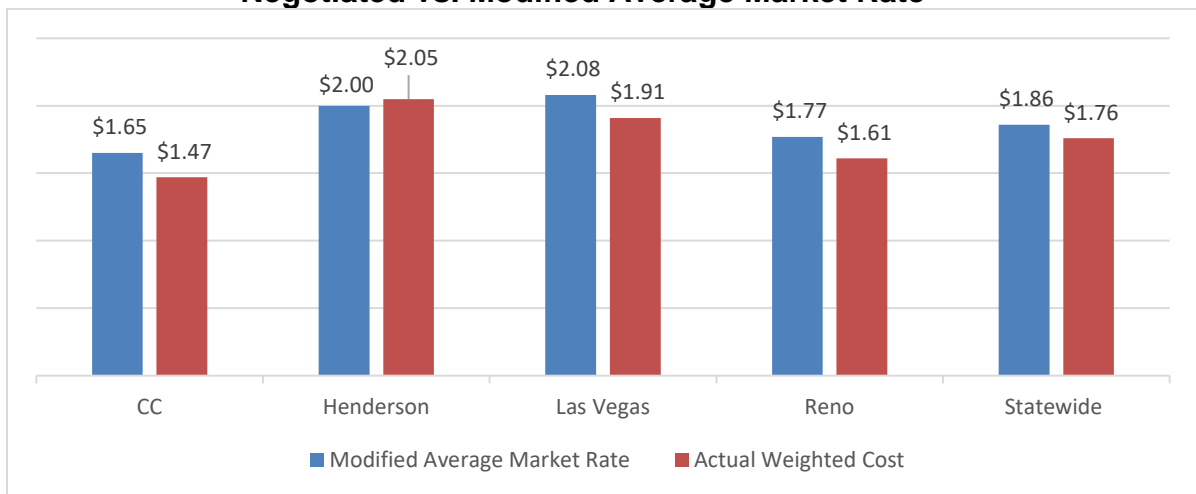
The sources used in the retrospective analysis do not provide a basis for weighting, and the range between all sources shows high variation. Also, the sources used for the retrospective analysis may contain market bias since they originate from entities incentivized to inflate outcomes.

#### Alternative Performance Analysis

We recalculated the average market rate by excluding the lowest of the low-range and highest of the high-range in the current-listings portion for each area. Our analysis shows the statewide negotiated rate is approximately 5% below average market rate. Exhibit IV shows negotiated rates against average market rates.

### Exhibit IV

#### Negotiated vs. Modified Average Market Rate



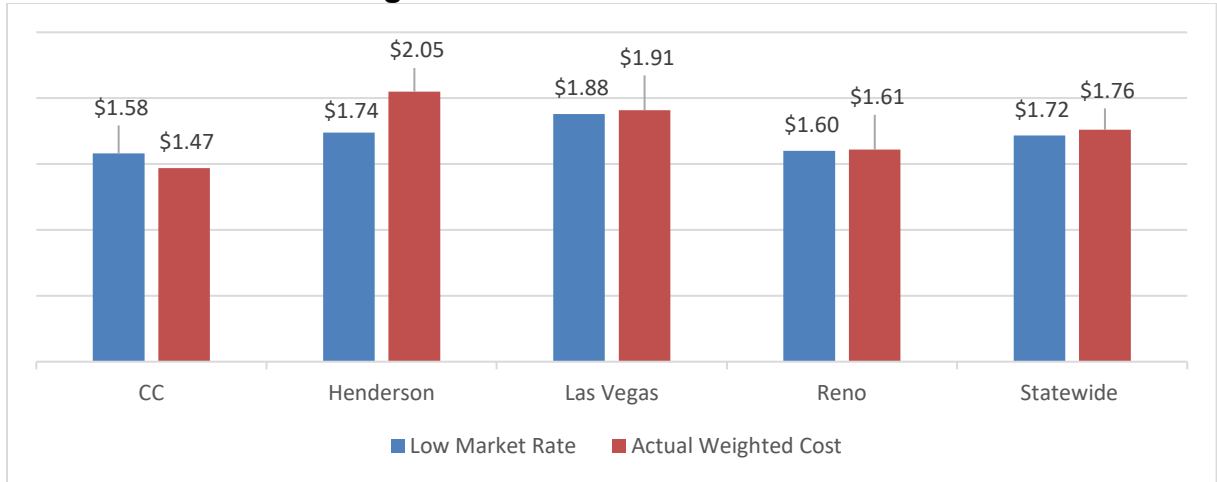
Source: Leasing Services' 2018-19 Market Analysis Workbook

Performance Comparison  
to Low-Market Range

Exhibit V shows a comparison of negotiated leasing rates to the low-range market rates provided in Leasing Services' source data. This comparison shows that the statewide average cost per square foot is 2.3% above the low-range market rates. See Exhibit V.

**Exhibit V**

**Negotiated vs. Low Market Rate**



Source: Leasing Services' 2018-19 Market Analysis Workbook

Multiple Listing Service Provides  
More Accurate Market Gauge

Leasing Services does not have access to MLS data for rate comparisons of current listings or recently closed transactions. Staff does not have access to complete information when negotiating leases on agencies' behalf.

We obtained Multiple Listing Service (MLS) data of commercial office space in Reno, Las Vegas, and Carson City. For Carson City, the data provided examples of current listings and recently closed transactions for office space in buildings where the state has active leases. No such examples were found for the Reno and Las Vegas markets. The Carson City examples showed the state is paying at or above market rates for much of this office space despite having engaged in long-term leases with much greater square footage than that advertised. See Exhibit VI.

**Exhibit VI**

**Current Agency Rate vs. Recent MLS Data**

<b>Location</b>	<b>Agency</b>	<b>Agency Lease Term</b>	<b>Agency SF</b>	<b>Recent MLS Listing Rate</b>	<b>Current Agency Rate</b>
1000, 1100 & 1050 E. William St., CC	DHCFP	36 Months	35,811	\$1.40	\$1.41
1000 E. William St., CC	B&I - AIW	120 Months	4,621	\$1.40	\$1.42
1050 E. William St., CC	Admin. - Hearings	120 Months	3,720	\$1.40	\$1.42
1150 E. William St., CC	PUC	120 Months	23,279	\$1.40	\$1.50
400 W. King, CC	Mineral Resources Commission	60 Months	3,123	\$1.36	\$1.32
400 W. King, CC	Admin. - DHRM	61.5 Months	1,610	\$1.36	\$1.28
400 W. King, CC	Agriculture	60 Months	993	\$1.36	\$1.42
400 W. King, CC	B&I - Ind. Rel.	60 Months	11,697	\$1.36	\$1.40
400 W. King, CC	HHS - DPBH	84 Months	5,750	\$1.36	\$1.43
			90,604	\$1.38	\$1.40
				Current Rate as % of Listed Market	101.6%

Source: Master Lease Log, Multiple Listing Service data

Our analysis shows comparing the negotiated rates to current market rates suggests first-hand access to MLS market data could be a valuable tool in the negotiating process. The state's benefit could be approximately \$2.8 million annually. See Exhibit VII.

## Exhibit VII

### Value of Best Market Information

Current Rate as percent of Market	101.6%
Target Rate as percent of Market	<u>95%</u>
Current Rate - Target Rate	<u>6.6%</u>
Statewide Avg. Rate	\$1.70
Current Rate - Target Rate	<u>6.6%</u>
Improvement \$/SF/Month	\$0.11
Statewide Office Leased SF	<u>2,100,000</u>
Monthly Benefit	\$235,620
x	<u>12</u>
Estimated Annual Benefit	<u>\$2,827,440</u>

Source: Exhibit VI calculation, State Survey, Auditor weighted-average statewide rate per Master Lease Log dated July 19, 2019

Ensuring staff have access to the best market information is essential to achieving a rate that reflects the strength of the state's negotiating position. Leasing Services should use MLS data to analyze market rates. One way to receive MLS data is to work with a licensed real estate broker. Arizona requires the use of a brokerage firm for all commercial lease office space contracts. The brokerage firm manages all state leases proactively by engaging the agency up to one year before expiration of the current lease. Another surveyed state has a list of five brokers approved by state purchasing to assist with commercial leases.<sup>9</sup> The remaining two surveyed states utilize the assistance of brokers on a case-by-case basis.<sup>10</sup> Another option would be an "in-house" licensed agent to represent the state's interest.

### Staffing May Not be Adequate

Leasing Services staff may not be adequate to ensure the state's negotiating power is optimized. Currently, four staff positions are assigned direct responsibility for the leasing process, which manages 329 commercial leases and binds the state to approximately \$41 million in annual budgetary commitments. Staff also manage the process of assigning state-owned office space to B&G supervised properties.

Leasing Services' staff is comprised of the following:

- One Management Analyst II (MAII), Grade 35, who serves as the Leasing Manager and primary negotiator;
- One Program Officer II (Grade 33);
- One Program Officer I (Grade 31); and
- One Administrative Assistant III (Grade 27).

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<sup>9</sup> Oregon

<sup>10</sup> Utah, Idaho

Traditionally, oversight of the Leasing Services function was the full responsibility of a Management Analyst IV (MAIV), Grade 39. This oversight role subsequently became a partial responsibility of the fiscal manager, also an MAIV. Due to internal restructuring of managerial resources a few years ago, the MAII Leasing Manager was given oversight as well as day-to-day operational responsibilities. Strategic planning for future needs and implementation of leasing best practices may suffer without a significant oversight presence of the leasing function beyond day-to-day operations

Surveyed states' leasing services staff have extensive experience and credentials in the real estate industry. While it is common for leasing agents in the surveyed states to have prior certifications as real estate agents or appraisers, those in oversight positions generally possess certifications as a Certified Commercial Investment Manager (CCIM), a Project Management Professional (PMP), or as a licensed attorney. An MA II position generally would not attract the interest of those with such qualifications.

### **Office Space Needs Not Publicized to the Open Market**

Nevada does not publicize office space needs. In Nevada, commercial office space leases are exempt from the competitive bidding requirements of NRS 333.<sup>11</sup>

Utah, Washington, Oregon, Idaho and Arizona publish office space needs in some form. Idaho requires a Request for Proposal (RFP) process for leases over 3,000 square feet or with terms greater than five years.<sup>12</sup> Washington publishes office space "bids" on its websites, and Oregon selectively uses the Request for Information (RFI) process and sometimes solicits bids in an effort to provide equal opportunity to the leasing community. Arizona, through its contracted broker, selectively publishes solicitations.

Publicizing office space needs could assist Leasing Services with its search for viable alternatives while simultaneously generating competitive interest. Increased competitive interest from building owners and property managers creates negotiating leverage for the lessee and expands opportunities among building owners. Shifting competitive advantage in favor of the lessee may result in concessions not otherwise available, such as lower rates or additional tenant improvement allowances.

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<sup>11</sup> NRS 333 governs the Request for Proposal (RFP) process, ensuring contracts meet a variety of transparency, vetting, and bidding requirements, and includes posting bids on the NevadaEPro public interface, which serves as a portal to inform, register, and manage competitive interest from potential vendors.

<sup>12</sup> Processed through the Idaho Permanent Building Fund Council.



## **Interim Term Increases Are Not Based on Market Data**

The cumulative effect of automatic interim increases may create rates during the lease term in excess of market rates. Almost all of the leases reviewed (97%) had structured increases throughout the lease term. The disparity becomes especially pronounced in the later years of long-term leases, which may become the basis for renewal terms. In one example, a 15-year lease increased 120% over the lease term.<sup>13</sup> At present, the lease rate for this example is about 20% above average-market and will increase another 28% over the remaining six years.

Oregon reviews long-term leases mid-term to renegotiate the rate if interim increases have caused rates to significantly out-pace the market. Arizona generally does not include interim-term rate increases and is reluctant to engage in leases longer than seven years.

Linking interim increases to a market index may provide an objective basis for establishing interim-term increases; however, determining an appropriate index can be difficult. Idaho benchmarks interim increases to the Consumer Price Index. The basis for interim term increases should be based on objective benchmarks and disclosed during lease negotiations.

## **Tenant-Requested Improvement Costs are Not Transparent**

Many of the reviewed leases included tenant-requested improvements. The cost of those improvements is typically spread over the life of the lease. Fourteen of the thirty-one (45%) lease files reviewed noted tenant improvements but did not quantify the costs in the lease summary or lease agreement. Without specifying the improvement costs, it was not possible to determine the impact of the improvements on the negotiated rate.

Including tenant-requested improvement costs in the lease summary or lease agreement increases transparency in the review and approval process and identifies the impact of the costs on the negotiated rate. Otherwise, reviewers may incorrectly presume the negotiated rate reflects only the market value of the space without additional costs.

Also, quantifying tenant-requested improvement costs in the lease summary or lease agreement allows reviewers to determine if the lessor's costs recovered over the lease term represent a fair value for the improvements made at the tenant's request. Without an assessment of whether the costs recovered over the lease term are fairly reflected in the negotiated rate, lessors may over-recover for the requested improvements.

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<sup>13</sup> DPS – 475 Valley, Reno. This lease was negotiated in 2009 before DPS was required to go through Leasing Services for leases.

Finally, quantifying tenant-requested improvement costs in the lease summary or lease agreement allow retrospective performance analysis to be more accurate. Removing extraneous factors from the negotiated rate allows a more direct comparison to market rates. For instances where tenant-requested improvements or other items, such as furniture leased from the lessor, are included, calculating a gross rate which includes all items and a net rate which excludes tenant-requested items would be informative during the review and approval process and later for comparisons to market.

### ***Conclusion***

The strength of the state's negotiating position is not reflected in the negotiated rates for commercial office space leases. By allowing additional time for staff to explore viable options, soliciting GFO Budget Division intervention when the agency resists cost-effective alternatives, improving staff's access to the best market data, ensuring adequate staffing, publishing office space needs, monitoring interim-term rate increases, and reporting the impact of tenant-requested improvements, negotiated rates will align with the strength of the state's negotiating position and could benefit Nevadans by an estimated \$2.8 million annually.

### ***Recommendation***

1. Ensure negotiated rates for commercial office space reflect the strength of the state's negotiating position.

## ***Develop a Method to Ensure All Available State Office Space Options Are Considered***

Leasing Services should develop a method to ensure all available state office space options are considered. This process will allow more effective use of state office space and lead to cost savings. Nevada Revised Statutes (NRS) 331.110 requires the State Public Works Division (SPWD) Administrator to first explore available space in state owned or leased buildings before seeking commercial office space.<sup>14</sup> The state owns about 28 million square feet of real property structures, the vast majority of which are special purpose buildings not suited for office space.

NRS 331.110(4) requires two inventories to be reported annually to the SPWD Administrator. The Legislature's intent was that these reports would be compiled and posted on SPWD's website to provide information regarding the availability of space for state agency consideration.<sup>15</sup> NRS 331.110 specifies the content of each inventory must identify:

- Real property that is being actively used;
- Real property that is not being actively used;
- Real property that is not being used, but which is reasonably anticipated to be actively used in the future; and
- Real property that is being actively used as a park or wildlife area.

Neither of the two required inventories are being reported to the SPWD Administrator in a manner that facilitates the Legislature's intent.

### **Agencies Not Reporting Annual Leased Inventories**

The first required inventory relates to leased property and applies to all agencies. NRS 331.110(4) states, in part:

“Each state officer, department, agency, board and commission shall maintain and, on or after April 1 but not later than June 30 of each year, provide to the Administrator an inventory of all real property leased to the State that is occupied by or otherwise used...”

Agencies are not reporting this inventory to SPWD. The current lease log posted on SPWD's website does not contain “all real property leased to the State.” Certain

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<sup>14</sup> NRS 331.110(3): “...before the Administrator enters into any lease for office rooms for any state officer, department, agency, board or commission pursuant to subsection 1, the Administrator shall consider, without limitation:...(b) The availability of space for use by the state officer, department, agency, board or commission, as applicable, in buildings that are owned by or leased to the State;”

<sup>15</sup> AB 404, 2011 Regular Session, Assembly Committee on Government Affairs, minutes dated April 6, 2011; Assembly Committee on Ways and Means, minutes dated May 27, 2011; and Senate Committee on Government Affairs, minutes dated June 1, 2011.

agencies, such as NDOC, NSHE and certain boards may negotiate their own leases independent of Leasing Services. The inventory of leased property presently posted on SPWD's website also fails to meet the intent of NRS 331.110(4) by not providing an annual update related to the availability of space in currently leased buildings. Leasing Services and other agencies seeking office space are not aware of vacant space in currently leased buildings because the information is not complete or current.

### **State-Owned Building Inventories Not Meeting Legislative Intent**

The second required inventory relates to state-owned property but is limited to three agencies:

“...The Division of State Lands of the State Department of Conservation and Natural Resources, Nevada Department of Transportation and State Public Works Division of the Department of Administration shall maintain and, on or after April 1 but not later than June 30 of each year, provide to the Administrator an inventory of all real property owned by the State.”

These inventories are reported but do not include information that would assist the Administrator with considering state-owned office space options before seeking commercial office space.

The state-owned building inventory currently posted on the SPWD's website does not comply with the requirements of NRS 331.110(5). Statute requires:

“...the Administrator shall post on an Internet website maintained by the State a list of all real property owned or leased by the State. Each such listing shall include, without limitation, a brief description of:  
(a) The location, size and current use of the real property, including, without limitation, whether the real property is actively used...”

The inventory of state-owned property presently posted on SPWD's website is updated during the facility condition analysis process on approximately a six-year cycle as construction project coordinators perform routine inspections on state-owned buildings.<sup>16</sup> The status updates note whether the building is vacant but is otherwise silent on whether the building is reasonably anticipated to be used.

### **Information Provided Does Not Identify Office Space**

Available state office space options are not transparent without complete information. Statute requires the list of property posted on SPWD's website to include a “brief description of: (a) The location, size and current use of the real

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<sup>16</sup> NRS 341.128

property...” The purpose of the website posting requirement is to provide visibility to other agencies. This listing would show available state owned or leased space which agencies could occupy instead of commercial leases.

A review of the current posting provides only a generic description that renders the information unusable by the Administrator for purposes of carrying out the duty to consider state owned or leased options prior to engaging in commercial leases for office space.

SPWD’s draft regulations do not require reporting agencies to identify which properties contain office space in the “brief description.”<sup>17</sup> Without clarification from SPWD, reporting agencies will continue to provide generic descriptions that do not identify office space that may be considered in lieu of commercial space.

### **Leasing Services Does Not Consider Available Non-B&G Space**

Currently, Leasing Services only considers available office space in B&G supervised properties when agency space requests are submitted. B&G supervised state-owned properties are essentially full. Agencies prefer B&G supervised properties because, in addition to other benefits, the monthly rate is significantly less than commercial options.<sup>18</sup>

NRS 331.110 does not restrict Leasing Services’ consideration to B&G supervised properties. At this time, the data from other agencies related to vacant space is not compiled in a useful manner; therefore, Leasing Services is not aware of availability in non-B&G properties. As a result, some commercial leases for office space may be unnecessarily pursued when state options are available.

### **Average Market Rate Exceeds the Rental Rate for State-Owned Buildings**

The monthly rental rate for state-owned office space is currently \$1.07 per square foot. As noted earlier, the statewide average commercial office rental rate is \$1.76 per square foot. A \$0.69 per square foot (39%) difference could yield significant cost savings if state owned or leased options are fully utilized. Assembly Bill 404 envisioned a concept whereby SPWD becomes a central repository for annual updates of a complete list of real property owned and leased to the state.<sup>19</sup> Because the provisions of AB 404, as codified in NRS 331.110(4)(5), have not been fully developed, it is not yet possible to estimate the amount of commercial office lease cost that can be avoided.

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<sup>17</sup> Revised Proposed Regulations LCB File No. R077-17, dated December 19, 2018.

<sup>18</sup> GFO Budget Division “Rent Schedule.”

<sup>19</sup> 2011 Regular Session.

## ***Conclusion***

Developing a method to ensure all available state office options are visible when agencies and Leasing Services consider office space needs could reduce lease costs. The Administrator cannot fully explore all available state space options before seeking commercially leased office space without information from state agencies pursuant to the requirements of NRS 331.110(4). This lack of information may result in commercial leases for office space that could be satisfied through existing leased and state-owned resources.

## ***Recommendation:***

2. Develop a method to ensure all available state office space options are considered.

## Appendix A

### Scope and Methodology, Background, Acknowledgements

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#### Scope and Methodology

We began the audit in July 2019. 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 September 2019.

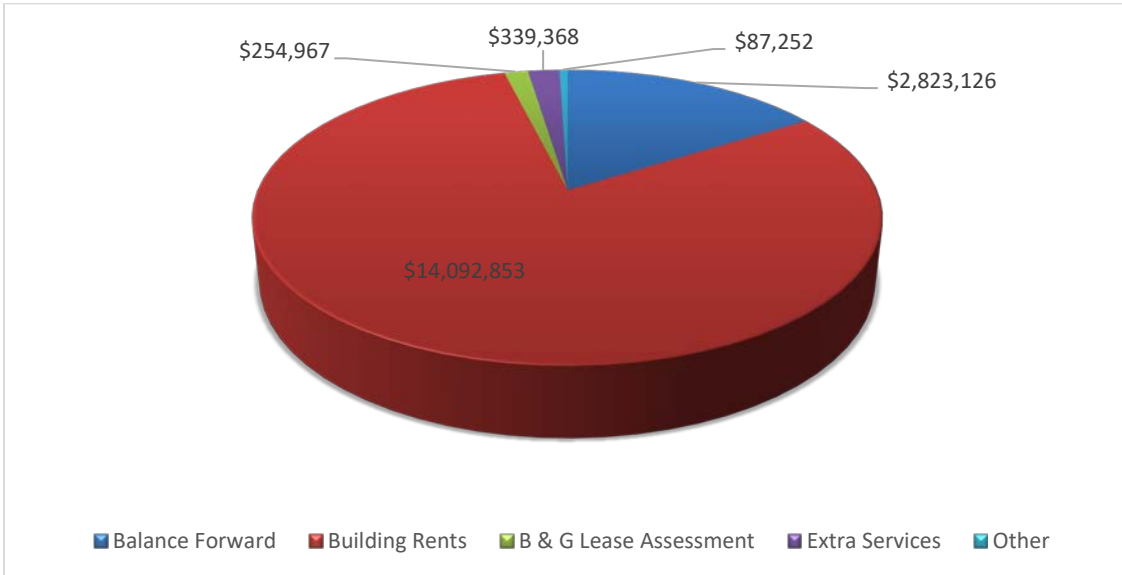
We conducted our audit in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

#### Background

The Buildings and Grounds Section (B&G) of the State Public Works Division (SPWD), contains Leasing Services. B&G provides physical buildings and grounds maintenance and housekeeping for most state-owned buildings in Carson City, Reno, and Las Vegas. Services are provided by B&G staff and contracted vendors ranging from janitorial and maintenance to minor remodeling. Leasing Services also provides office space for agencies in state-owned buildings, and when not available, locates and negotiates leases in privately owned buildings through Leasing Services. Additionally, SPWD provides administrative oversight of the Marlette Lake Water System.

B&G is funded by building rents for supervised properties, assessments for commercial leases, and revenues for extra services provided by B&G staff. B&G budget for fiscal year 2020 was approximately \$17.6 million. Exhibit VIII summarizes B&G's budget by funding source for fiscal year 2020.

**Exhibit VIII**  
**State Public Works Division – Buildings and Grounds Funding Sources**  
**Fiscal Year 2020**



Source: Fiscal Year 2020 Legislatively Approved Budget.  
 Notes: "Other" includes refunds, rebates, and miscellaneous sales.

**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

# Buildings and Grounds Section Response and Implementation Plan

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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: October 16, 2019  
Re: Response to Audit DIA Report 20-02 Leasing Services

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Thank you for the State Public Works Division's (SPWD) final report of the Division of Internal Audits' findings regarding Leasing Services. We 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.

**Recommendation #1: Ensure negotiated rates for commercial office space reflect the strength of the state's bargaining position. Leasing Services should ensure negotiated rates for commercial office space reflect the strength of the state's bargaining position by:**

- **Recommendation #1a: Increasing the timeline requirement for agencies to submit space requests;**

The SPWD understands and accepts the audit recommendation. The division will adjust timeline regulations to allow agencies adequate time to submit space requests so Leasing Services can investigate office space alternatives or negotiate better lease rates

- **Recommendation #1b: Ensuring staff have access to the best market information;**

The SPWD understands and accepts the audit recommendation. The real estate industry standard for market information is the Multiple Listing Service (MLS). However, the SPWD does not have the ability to access real time market information due to staff not have the realtor's license required to access the data. The ability to embrace this recommendation would be contingent on staff obtaining a real estate realtor's license.

- **Recommendation #1c: Providing adequate staffing;**

The SPWD understands and accepts the audit recommendation. The division will work with Internal Audits and other state Leasing Services to identify the appropriate staffing levels.

- **Recommendation #1d: Publicizing office space needs;**

The SPWD understands and accepts the audit recommendation. The division is exploring publicizing options and will develop a formal policy to establish guidelines.

- **Recommendation #1e: Monitoring interim term increases; and**

SPWD understands and accepts the audit recommendation. Leasing Services will rewrite the terms on leases longer than seven years to include language allowing for interim rate negotiations.

- **Recommendation #1f: Documenting monetary value of tenant-requested improvements.**

SPWD understands and accepts the audit recommendation. Leasing Services will obtain copies of contractor bids for tenant-requested improvements from lessors to substantiate the cost charged for tenant improvements. All tenant improvements will be added to the 'Statewide Lease Information' form in the remarks section.

**Recommendation #2: Develop a method to ensure all available state office space options are considered. NRS 331.110(4) requires two inventories to be reported annually to SPWD. The Legislature's intent was that these reports would be compiled and posted on SPWD's website to provide information regarding the availability of space for state agency consideration**

- **Recommendation #2a: Agencies Not Reporting Annual Leased Inventories;**

The SPWD understands and accepts the audit recommendation. The division will revise regulations to require agency reporting in compliance with NRS 331.110(4) which states, in part:

"Each state officer, department, agency, board and commission shall maintain and, on or after April 1 but not later than June 30 of each year, provide to the Administrator an inventory of all real property leased to the State that is occupied by or otherwise used..."

- **Recommendation #2b: State-Owned Building Inventories Not Meeting Legislative Intent;**

The SPWD understands and accepts the audit recommendation. The division will revise regulations to require specific description of office space in compliance with NRS 331.110(5) which states, in part:

"...the Administrator shall post on an Internet website maintained by the State a list of all real property owned or leased by the State. Each such listing shall include, without limitation, a brief description of:  
(a) The location, size and current use of the real property, including, without limitation, whether the real property is actively used..."

- **Recommendation #2c: Leasing Services Does Not Consider Available Non-B&G Space**

The SPWD understands and accepts the audit recommendation. Leasing Services will develop a system to access data in a meaningful way and use it to rent out non-B&G space.

## Appendix C

### Timetable for Implementing Audit Recommendations

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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.

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

<u>Recommendations</u>	<u>Time Frame</u>
1. Ensure negotiated rates for commercial office space reflect the strength of the state's bargaining position. (page 14)	May 2020
2. Develop a method to ensure all available state office space options are considered. (page 18)	May 2020

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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.