Opportunities Exist to Improve the Efficiency of the State's Administrative Services

Final Report to the Joint Legislative
Program Evaluation Oversight Committee

Report Number 2018-04

March 30, 2018

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John W. Turcotte
Director

March 30, 2018

Senator Brent Jackson, Co-Chair, Joint Legislative Program Evaluation Oversight Committee
Representative Craig Horn, Co-Chair, Joint Legislative Program Evaluation Oversight Committee

North Carolina General Assembly
Legislative Building
16 West Jones Street
Raleigh, NC 27601

Honorable Co-Chairs:

Session Law 2017-57 directed the Program Evaluation Division to evaluate the efficiency of the divisions and administrative activities of the Department of Administration and provide recommendations to reduce division costs.

I am pleased to report that the Department of Administration cooperated with us fully and was at all times courteous to our evaluators during the evaluation.

Sincerely,

John W. Turcotte
Director

PROGRAM EVALUATION DIVISION
NORTH CAROLINA GENERAL ASSEMBLY

April 2018 Report No. 2018-04

Opportunities Exist to Improve the Efficiency of the State's Administrative Services

Summary

The Department of Administration (DOA) acts as the business manager for North Carolina state government and provides internal services and programs for state departments. DOA oversees operations such as construction, purchase and contracting for goods and services, operation of a centralized motor fleet, acquisition and disposition of real property, and operation of auxiliary services such as parking, mail services, facility maintenance, and police protection for state government property.

Session Law 2017-57 directed the Program Evaluation Division to evaluate the efficiency of the divisions and administrative activities of DOA and provide recommendations to reduce division costs.

The Program Evaluation Division identified opportunities to improve operational efficiencies in six divisions. These efficiency opportunities include:

- transitioning employees from high-value state-owned properties to leased properties in lower cost locations,
- establishing and ensuring compliance with space standards for each state-owned and leased office facility,
- increased use of contracted services to perform facility management activities for state-owned facilities,
- enhanced monitoring and compliance with state term contracts,
- increased use of competitive bidding for contracted services,
- effective use of information from newly-installed telematics to reduce fleet vehicle inventory and mileage,
- electronic scanning of incoming mail,
- reduction in outgoing mail service costs through increased use of electronic communications,
- increased utilization of the State's presort mail contract for outgoing mail, and
- leasing underutilized parking spaces to private entities.

Additional operational efficiencies can be achieved through the establishment of legislative performance measures for these divisions. To ensure each of these efficiency opportunities are fully explored, the General Assembly should require that business case analyses be performed and statutes be amended to include legislative performance measures. In addition, to ensure the proper conduct and timely delivery of recommended actions, the Department of Administration should be directed to establish a dedicated Project Management Office.

Purpose and Scope

Session Law 2017-57 directed the Program Evaluation Division to conduct measurability assessments and efficiency evaluations of the programs and administrative activities of the Department of Administration (DOA) and provide recommendations to reduce program costs. The legislation also directed the Program Evaluation Division to consult with the Office of the State Auditor to identify programs and activities that, with changes, may produce cost savings. The General Assembly also allocated $150,000 for the Program Evaluation Division to obtain contracted services to assist in the identification and evaluation of potential cost-savings opportunities.

In addition, the legislation directs the State Auditor to review draft findings and recommendations and provide a written response to be included in the final report. Finally, the legislation directs that the Program Evaluation Division's findings and recommendations be presented to the Joint Legislative Program Evaluation Oversight Committee, Joint Legislative Oversight Committee on General Government and, upon request, to other committees.

The Program Evaluation Division collected data from several sources including

- a review of information provided by DOA in conjunction with its Measurability Assessment,
- a review of laws and policy guiding DOA,
- interviews and queries of DOA division managers,
- available performance measures for DOA programs, and
- initiatives pursued by other states to improve the efficiency of programs similar to those in DOA.

Study Methodology

The Program Evaluation Division identified opportunities to reduce program costs. In addition to potential reductions in costs, the analysis of each identified efficiency opportunity considered the feasibility and cost of implementation as well as the ability to quantify the results upon full implementation. In addition, successful implementation of each identified efficiency opportunity is defined by the capacity to realize potential efficiencies without adversely affecting achievement of associated program outcomes.

Evaluation of each efficiency opportunity includes consideration of the information necessary for the General Assembly to make an informed decision to proceed with implementation. Regarding those efficiency opportunities for which the requisite information is not available, the Program Evaluation Division recommends a multi-stage approach. The first stage includes recommendations to obtain appropriate information necessary to evaluate potential alternatives and reliably calculate expected cost savings including any resource requirements. The recommendation to perform this analysis is based on available information and results from similar initiatives by other government entities.

Results from the initial stage of the evaluation can be used by the General Assembly to decide whether to proceed with implementation of the efficiency opportunity. The information provided for this decision will be a business case that includes projected cost savings and investment requirements based on valid and reliable data and consideration of all relevant factors.

To help ensure that the General Assembly can continually monitor and evaluate the impact of each identified efficiency opportunity, recommended efficiency measure(s) for the associated divisions are also identified. Each recommended efficiency measure includes required data needed to ensure the measure provides the General Assembly with valid and reliable information to evaluate the monetary impact of each recommendation and regularly monitor the overall efficiency of each division. For those recommended efficiency measures that currently lack sufficiently valid and reliable data, the Program Evaluation Division included recommendations for obtaining the data as part of the initial stage of the efficiency opportunity development process.

Background

The Department of Administration provides centralized administrative support for state agency operations. The Department of Administration (DOA) acts as the business manager for North Carolina state government and provides internal services and programs for state departments. DOA oversees operations such as construction, purchase and contracting for goods and services, operation of a centralized motor fleet, acquisition and disposition of real property, and operation of auxiliary services such as parking, mail services, facility maintenance, non-public education services, and police protection for state government property.

Additionally, DOA hosts groups that advocate for North Carolinians including the Commission of Indian Affairs, Council for Women and Youth Involvement, and the Office for Historically Underutilized Businesses.

In Fiscal Year 2016–17, DOA expended $260.0 million and was authorized 457 full-time equivalent positions.

Efficiency Opportunities

Division: State Property Office

Division Description: The State Property Office is responsible for acquisitions, dispositions, and management of state land and buildings per various statutes. The State Property Office is the centralized clearing house within the Department of Administration that manages the State's real estate transactions.

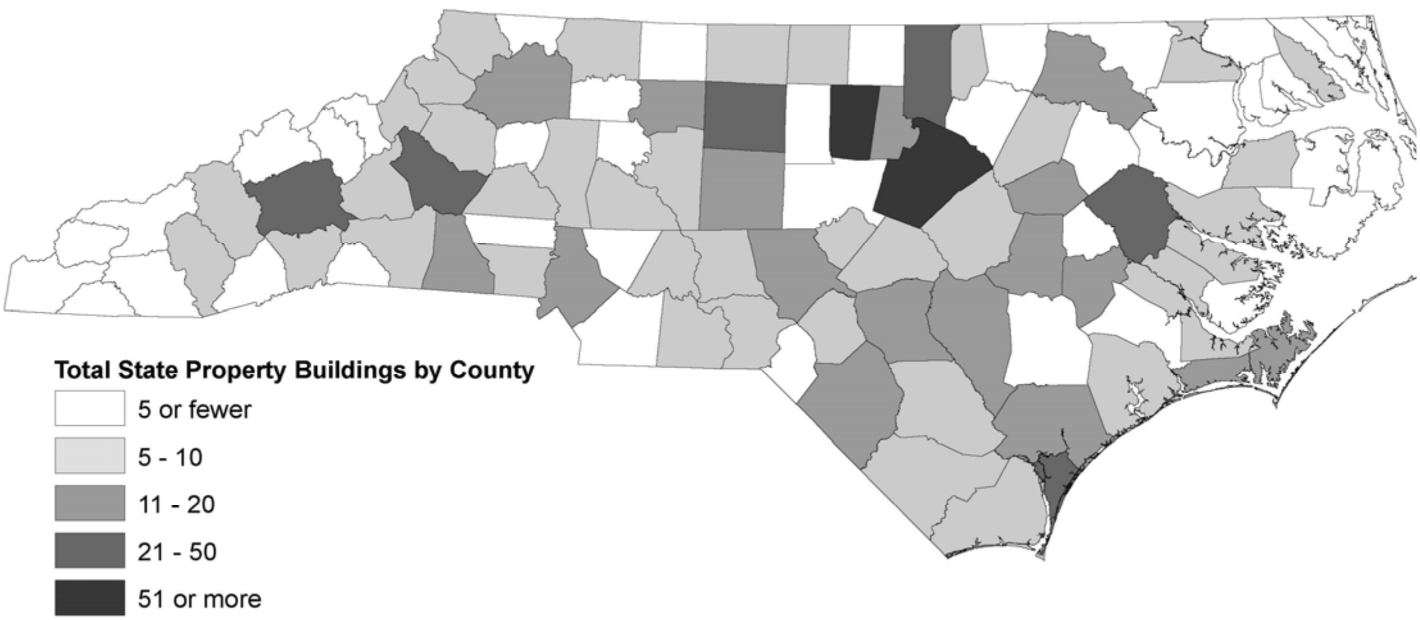
The primary mission of the State Property Office is to

- manage the State's real estate transactions on behalf of state agencies through deeds, leases, easements, licenses, or otherwise;
- administer the State's unappropriated and submerged lands; and
- maintain a complete and accurate inventory of state-owned lands, buildings, and space in buildings for use by state agencies to efficiently and effectively manage their allocated properties.

In Fiscal Year 2016–17, the State Property Office was authorized 19 full-time equivalent positions and expended $2.1 million.

As shown in Exhibit 1, state-owned and leased facilities are located throughout North Carolina. Though nearly every county has at least one facility, Wake County contains by far the most state-owned office space of any county in North Carolina. Specifically, the Department of Administration reported that in Raleigh alone there are 147 state-owned office properties totaling 4 million net square feet (NSF) that provide office space to state employees.[1]

Exhibit 1: State-Owned and Leased Facilities Are Located Throughout North Carolina



Source: Program Evaluation Division based on data provided by the Department of Commerce.

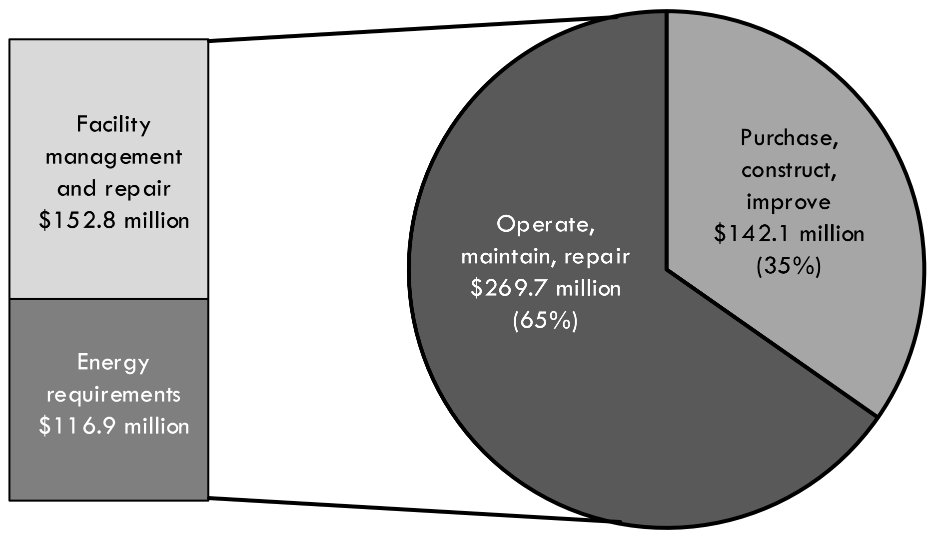
State-owned facilities have an estimated $4.7 billion in deferred maintenance and repairs (DM&R) requirements.[2] In 2015, CBRE, Inc. performed a study of state-owned property that estimated the value of the deficiencies for all state-owned facilities at $4.7 billion with approximately $2 billion associated with full-building renovations.[3] CBRE, Inc. attributed the remaining $2.7 billion to facility deficiencies with half ($1.35 billion) of that subtotal associated with immediate and near-term (five-year) needs.

In Fiscal Year 2016–17, the State spent $411.8 million on state-owned agency facilities. These expenditures were used for investments and capital improvements to the State's facility infrastructure and to operate,

[1] The State Property Office defines net square footage as the area to be leased for occupancy by state personnel and/or equipment. To determine net square footage: 1. Compute the inside area of the space by measuring from the normal inside finish of exterior walls or the room side finish of fixed corridor and shaft walls, or the center of tenant separating partitions. 2. Deduct from the inside area the following: toilets and lounges, entrance and elevator lobbies, corridors, stairwells, elevators and escalator shafts, building equipment and service areas, stacks, shafts, and interior columns, and other space not usable for state purposes.
[2] As defined in Statement of Federal Financial Accounting Standards 40, deferred maintenance and repairs (DM&R) refers to maintenance and repair activity that was not performed when it should have been performed or was scheduled to be done and was delayed to a future period.
[3] CBRE, Inc. (2015, June). *Real Estate Capital Improvement Needs Analysis and Evaluation Study*. Prepared for the State of North Carolina.

maintain, and repair state-owned facilities. As shown in Exhibit 2, $142.1 million was expended to purchase, construct, and improve state-owned facilities, whereas $269.7 million was expended to operate, maintain and repair state-owned facilities. Nearly $153 million of this latter amount was expended on facility management and repair services with the remaining $116.9 million expended to meet facility energy requirements.

Exhibit 2: In Fiscal Year 2016–17, the State of North Carolina Spent $411.8 Million on Facilities Used by State Agencies



Source: Program Evaluation Division based on data obtained from the North Carolina Accounting System (NCAS).

<u>Efficiency Opportunity 1:</u> Cost-effective achievement of state occupancy standards

The contemporary workplace in both the public and private sectors is changing. Advancements in the way work is accomplished, especially through the vastly expanded use of technology to communicate and deliver information, have changed not only the tools utilized to do work but also the way people use the workplace. Specifically, employee facility space requirements are shrinking as public and private entities adapt to the changing workplace environment. For example, expanded use of available technology allows for greater use of telecommuting.

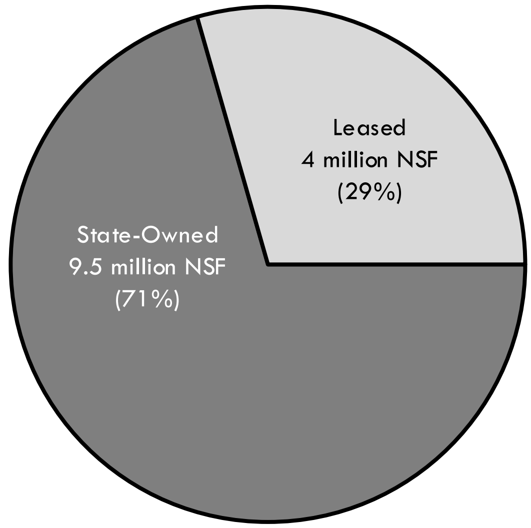
Workplace designs are also changing to enhance employee productivity. For example, whereas office space requirements may be shrinking due to increased use of work stations, more areas for collaboration are being added to office space designs. Finally, new office spaces are increasingly embracing more natural light and ties to the outdoors to create a work environment that promotes efficiency and satisfaction.

Cost-effective utilization of office space to achieve the State's goals and objectives can help reduce overall facility management costs. As shown in Exhibit 3, in Fiscal Year 2016–17, the Department of Administration was responsible for the management of 1,689 facilities encompassing 13.5

million NSF that had been designated for use as office space. This total is comprised of 1,059 state-owned facilities totaling 9.5 million NSF and 630 leased facilities totaling 4.0 million NSF.

Exhibit 3

In Fiscal Year 2016–17, the State Property Office Managed 13.5 Million Net Square Feet of Office Space



Source: Program Evaluation Division based on data provided by DOA.

The purposes of the 2015 study conducted by CBRE, Inc. were to assist the State with its real estate planning, to match space planning requests with the State's existing portfolio, and to make recommendations for repurposing state-owned assets for either private development or other state use. Some of the key findings from the study were:

- Based on a survey of ten state-owned properties in downtown Raleigh, it was estimated that state agencies use an average of 319 net square feet (NSF) per FTE. Current commercial and government standards average between 175-200 NSF per FTE. CBRE, Inc. primarily attributed the State's higher space utilization rate to older, less efficient buildings and poor utilization of existing space.
- If North Carolina were to employ current industry workplace strategies such as open floor plans, digital file storage, and collaborative/flexible work spaces, the State could substantially reduce its net square footage per FTE. Other benefits of applying current workplace trends would include:
    - reduced real estate costs through efficient design,
    - improved productivity through collaborative work spaces, and
    - improved staff morale by creating a more interactive work environment.
- The State does not have real-time access to FTE counts and total occupancy costs per location, owned or leased. These data are critically important for effective portfolio management.

The study recommended that Department of Revenue employees be relocated to a suburban, single-story facility with adequate parking and staff from the Department of Administration be relocated to a renovated

Revenue building. The Department of Administration's building should then be redeveloped through sale or lease to a private entity.

Reducing the average amount of office space utilized by state employees is a cost-effective way to reduce facility management costs. However, the State Property Office does not have sufficient information to determine the average number of NSF per employee at each state-owned and leased office facility. Specifically, the State Property Office does not have readily-available and valid information identifying employees assigned to each office facility. Consequently, State Property cannot optimize office space designs to minimize the cost to house each employee while contributing to achievement of state goals and objectives.

The amount of space allocated to each employee should be unique for each state-owned and leased office facility. Office space standards should not be based solely on a fixed amount of net square feet per person. Effective office space designs should include consideration of the ratio of open workstations to closed offices, the amount of collaborative spaces required, and the potential for establishing alternative workplace strategies. In addition, the work environment of employees should also be considered. For example, an office that houses mostly field staff should be able to achieve an efficient design by implementing unassigned "touchdown" seats for those who work mostly outside the office. Conversely, work requirements with a high percentage of walled offices or client meeting rooms will likely result in less-efficient utilization.

The State may be able to realize large cost savings by reducing the average number of NSF occupied by employees to the applicable target utilization rate. For state-owned facilities, associated cost savings can be achieved either by transitioning employees out of leased spaces and allowing for the lease to no longer be necessary, or by transitioning employees from another state-owned facility to enable the sale or lease of all or part of that facility.

However, assigning more employees to a state-owned facility may also entail substantial costs, particularly with regards to renovations. For example, as shown in Exhibit 4, based on a review of Wake County real estate records none of the state-owned facilities surrounding the Old Capitol building in downtown Raleigh has been renovated since 1980 and the Old Revenue building has never been renovated since its construction in 1927. In some instances, the tax assessed value of the property and associated land for these facilities is less than the cost of DM&R requirements. In many instances, the time and investment necessary to perform these renovations may offset any cost savings that could be realized through the assignment of additional employees to the facility.

Exhibit 4: State-Owned Office Facilities in Downtown Raleigh Have Not Been Renovated in Several Decades

Building	Address	NSF	Year constructed	Year renovated
Highway Building	1 S. Wilmington St.	137,023	1951	1968
Highway Building Annex	101 E. Morgan St.	38,040	1918	1968
Agriculture	2 W. Edenton St.	50,981	1923	1970
Agriculture Annex	102 N. Salisbury St.	45,945	1954	1975
Labor	4 W. Edenton St.	24,926	1888	1970
NC Department of Justice	114 W. Edenton St.	121,447	1938	1975
Old Revenue	2 S. Salisbury St.	102,606	1927	1927
Justice	2 E. Morgan St.	48,539	1940	1980
Court Of Appeals	1 W. Morgan St.	34,239	1913	1975
TOTALS		**603,746**		

Source: Program Evaluation Division based on a review of Wake County real estate records and data provided by DOA.

The State can more cost-effectively reduce its facility management costs for leased office space. As shown in Exhibit 5, as of June 30, 2016, DOA was responsible for managing 647 leases for office space totaling 4.1 million NSF. Most of these leases will be expiring in the next few years. A total of 323 of these leases comprising over 1.6 million NSF will have expired by the end of Fiscal Year 2017-18, 182 of which (totaling over 1 million NSF) expired prior to July 1, 2017.

Exhibit 5: Expiring Office-Space Leases Provide the Best Opportunity to Cost-Effectively Achieve Space Standards

Lease Expiration	Number of Properties	Net Square Feet (NSF)	Average cost/NSF	Total Annual Cost
Before July 1, 2017	179	1,002,991	$15.63	$15,677,628
July 1, 2017- June 30, 2018	135	604,808	16.07	9,718,492
July 1, 2018- June 30, 2019	103	383,743	15.48	5,938,584
July 1, 2019- June 30, 2020	90	368,706	17.47	6,441,072
July 1, 2020 – June 30, 2021	53	513,891	15.54	7,985,509
July 1, 2021- June 30, 2022	30	315,686	15.80	4,987,927
After June 30, 2022	40	786,542	15.53	12,060,660
Total	**630**	**3,976,367**	**$15.80**	**$62,809,871**

Source: Program Evaluation Division based on data provided by DOA.

Expiring leases for office space represent the best opportunity to reduce the amount of space allocated to each employee and to realize significant cost savings. Unlike state-owned office space, the State can include specific office space designs as part of new lease agreements. Expenditures can be limited to employee moving expenses and new furniture requirements; consequently, cost savings associated with achievement of reduced employee space allocations can be achieved without incurring extensive facility renovation costs.

However, real-time access to an accurate listing of positions assigned to each state-owned and leased office facility is required to fully realize this opportunity to reduce facility management costs. Currently, DOA does not have ready access to this information and must rely on one-time surveys to determine the number of employees assigned to a facility. In addition, DOA does not have information on the type of work performed by each assigned employee, further limiting its ability to ensure office space designs cost-effectively contribute to each agency's goals and objectives.

In summary, the state of North Carolina spent $411.8 million during the fiscal year on state-owned facilities utilized by state agencies. Reducing the average amount of office space used by state employees is a cost-effective way to reduce facility management costs. However, the amount of space allocated to each employee should be unique for each state-owned and lease office facility given differences among workplaces and types of work being performed. The State can more readily reduce its facility management costs for leased office space by renegotiating expiring leases to include updated designs that meet space standard requirements.

Recommendation 1: The General Assembly should direct the Department of Administration to establish and enforce space utilization criteria for each state-owned and leased office facility.

As discussed in Efficiency Opportunity 1, the Department of Administration does not have sufficient information to ensure both state-owned and leased facilities are being effectively utilized. To help ensure the cost-effective operation of office facilities, the General Assembly should direct DOA to establish and enforce space utilization criteria for each state-owned and leased office facility.

In addition, to ensure DOA has sufficiently valid and reliable information to cost-effectively ensure achievement of the goals and objectives of its associated facility asset programs, the General Assembly should direct DOA to establish guidelines for determining employee office space usage requirements to include office time requirements, eligibility for telecommuting, and other applicable requirements, such as privacy.

Based on these guidelines, agencies should then be required to provide the Office of the State Controller (OSC) with the associated office space requirements for each employee. OSC should be required to develop procedures to establish and maintain a valid and reliable listing of the facility housing requirements of each authorized state employee. This information should be maintained on the State's Payroll System, BEACON, and should be readily available upon request.

Specifically, BEACON should be updated to include the unique identifier and address of the facility for each authorized state position, as well as information to identify the specific office space requirements. DOA should be directed to provide OSC with a listing of each office space category required to determine the most cost-effective office space standards for each facility. At a minimum, these identified categories should identify employees with

- limited office space time requirements,
- specific privacy requirements to comply with federal and state law,
- eligibility for telecommuting, and
- geographic location requirements.

As stipulated in G.S. § 143-341(4), this information should be incorporated in the database of all owned and leased buildings.

Efficiency Opportunity 2: Transitioning employees from state-owned property to leased properties in lower-cost locations

Many state-owned facilities were acquired over 50 years ago. These acquisitions were based on business operating strategies that may not be valid today or are changing due to economic conditions, technological advances, or a changing customer service delivery model. As a result, the current inventory of state-owned property may no longer be cost-effectively contributing to the State's goals and objectives.

Downtown Raleigh is enjoying unprecedented growth and demand for all types of space (land, retail, residential, office, educational) that is driving large increases in select property values. Downtown Raleigh's population has increased 53% since 2000 and is poised for an increase of nearly 40% with the new supply of apartments and condos being completed. Land sites in downtown Raleigh have reached unprecedented values due to the surge in residential, commercial, and retail development.

The State can potentially realize several benefits by transitioning certain employees from high-value state-owned facilities to lower-cost leased facilities. Utilization of state-owned facilities located in high-value locations to provide office space for state employees may not be the most cost-effective use of these assets. For example, for many employees there may no longer be an operational necessity to be located in downtown Raleigh. Transitioning these employees from these high-value state-owned facilities to lower-cost leased facilities can serve to:

- generate additional revenue to help fund other state priorities,
- lower the State's overall cost to house state employees,
- increase the overall effectiveness of agency operations, and
- increase local property tax receipts.

These benefits are explained in greater detail below.

Generate additional revenue to fund other state priorities. The Program Evaluation Division analyzed selected state-owned properties located in downtown Raleigh. Each of these state-owned facilities are located near the State's Old Capitol building and are currently used to house state employees. As shown in Exhibit 6, each of these state-owned facilities and associated land has a high tax assessed value. In addition, many of these facilities also have high deferred maintenance and repairs (DM&R) requirements that exceed tax-assessed valuation. For example, the Old Revenue Building has DM&R requirements exceeding its tax-assessed value by $4.5 million. However, though the value of the facility may be less than the DM&R requirements, the land on which the facility is located is valued at $4.1 million. To realize this potential additional revenue, up-front transition costs may be required. Depending on whether the property was sold or the type of lease, the cost of moving employees and incurring the cost of an additional lease may be required before any revenue can be generated from the sale of the state-owned property. In addition, the sale of a property or the establishment of a long-term lease may also limit the ability to move employees back into the geographic area of the state-owned property if market conditions or state requirements change.

Lower the State's overall cost to house state employees. Transitioning state agency operations from a state-owned to a leased facility contributes to a reduction in NSF needed to house state employees. Each of the options described above moves state employees from high commercial value buildings with significant maintenance needs to lower-cost leased space where landlords addresses maintenance issues. These transitions also facilitate the more efficient use of fewer net square feet per employee as part of overall plans.

In addition, for each potential option, consideration should be given to DM&R requirements. High levels of DM&R make it difficult to improve workplace environments in order to help ensure workers are most effectively contributing to the achievement of state agency goals and objectives.

Increase the overall effectiveness of agency operations. Transitioning state agency operations from a state-owned to a leased facility can help increase state agency performance and improve employee morale. As was shown in Exhibit 4, the identified state-owned office facilities were all constructed between 1888 and 1951. These buildings typically have too many private offices, lack natural light, and have an insufficient amount of collaborative space. Consequently, their design may no longer best facilitate the achievement of 21st century work requirements. In addition, the cost to redesign the work spaces in these facilities may be prohibitive because of the need for extensive renovations. To help ensure that a transition of state agency operations from their current locations does not adversely affect performance, it may be necessary to ensure that agency staff continue to be located in a single geographic location.

In addition, transition from a state-owned facility to a leased facility can also improve the productivity of state employees. For example, relocating state employees to locations closer to where they reside may result in a reduction in the time and cost to commute to and from their assigned office facility. In addition, the selection of a leased facility that provides ready access to public transportation can also serve to reduce employee commuting costs. Finally, leased facilities often provide free parking.

However, some employees may need to continue to be located in high-value-property locations to effectively perform their assigned duties. For example, employees requiring frequent and direct contact with members of the General Assembly or the Governor would continue to need to be located near downtown Raleigh to ensure continued effective communication and coordination among state agencies and other branches of government.

Increase local property tax receipts. The sale or lease of state-owned facilities to a private entity may also affect the amount of tax receipts that could be generated from these properties. State law exempts any state-owned facility from being subject to local property taxes.[4] However, when a state-owned facility is sold to a private entity, the property becomes subject to local property taxation. In addition, depending on the terms of a lease, some of the value of the lease may be subject to property taxes. For example, if the actual lease rate of a lease is lower than the prevailing market rate, the tenant will owe property taxes on the resulting leasehold rate, which is the difference between the actual and market lease rates.

There are multiple options to transfer some or all of the rights and responsibilities of a state-owned property to another public or private entity. The objective of any sale or lease of state-owned property should be to maximize the value to the public while satisfying the private entity that it will receive an appropriate return relative to the level of investment and risk that is undertaken. The sale or lease of a state-owned facility involves a shift in rights and responsibilities from the government to the private sector. Though the precise nature of this transfer should be considered separately for each facility, the associated process should ensure fairness, transparency, and accountability.

The sale or lease of a state-owned property serves to monetize the asset. Each option to transfer some or all of the rights and responsibilities of the facility to another entity has different implications with regards to timing of revenues and costs. For example, the sale or lease of a state-owned facility and subsequent transfer of employees to a leased facility may require actually leasing a facility well before any revenues could be generated from the sale or lease of the state-owned facility.

Some of the available alternatives to transfer rights and responsibilities to another private or public entity are:

- Retain ownership of the property (land and building) and lease the existing building to a private sector tenant.
- Retain ownership of the land, lease the land to a private sector developer, and allow the developer to build whatever type of building has the most commercial value.
- Sell the property (land and building) to the private sector.

Each of these options is explained in greater detail below.

Retain ownership and lease the high-value state building. In Fiscal Year 2016–17, the State's average annual cost per NSF for leased office space was $15.80 per NSF. For some properties located in areas with relatively high valuation, the rent that could be achieved through the lease of a facility could exceed the cost to house employees in a leased facility. In other words, if the State can rent a similar property for less than the potential rental income earned from a state-owned property, it provides an indication that selling or leasing the state-owned facility and transitioning employees to a leased facility may be in the State's economic interest. However, utilization of this option may entail significant up-front

[4] N.C. Gen. Stat. §. 105.278.1.

costs associated with addressing outstanding maintenance and renovation requirements.

Retain ownership of the land and offer a ground lease to the private sector. For state-owned assets located in high-value areas such as downtown Raleigh, the State may be able to realize a significant revenue stream from these facilities without having to make a large investment in maintenance and renovations. An example of a commonly used transaction that shifts some of the rights and responsibilities of a state-owned facility to a private entity is a ground lease. Under the terms of a ground lease for a state-owned property, the State would continue to own the property but in exchange for financial remuneration would permit the private entity to develop and use the property during the lease period, at the expiration of which the land and all improvements would be turned over to the property owner. Typical ground leases range from 75 to 99 years.

Utilization of a ground lease to transition state-owned property to commercial use can serve to transfer project development risks to the private sector while ensuring a predictable cash flow and reducing capital requirements. In addition, a ground lease enables the State to access private sector construction and market expertise. A ground lease can benefit the private entity because it does not require a down payment for securing the land as purchasing the property would require. Therefore, less equity is involved in acquiring a ground lease, which frees up cash for other purposes such as making improvements to the facility.

Sell the property. State-owned facilities may also be sold, which would generate a large one-time infusion of revenue. As also shown in Exhibit 6, these facilities had a total tax assessed value of $146.3 million. In addition, the value of the land where these facilities are located has an assessed value of $53.8 million.[5] Though these valuations do not reflect the actual proceeds that would be generated if these properties were sold, it demonstrates an indication of the one-time cash receipts that could be generated through the sale of these and other state-owned office facilities.

[5] The assessed valuation for land is the value of the parcel where the facility is located. For some parcels, there may be multiple facilities.

Exhibit 6: State-Owned Office Facilities in Downtown Raleigh Have High Value and Significant Reported Deferred Maintenance and Repairs Requirements

Building	Address	Tax Assessed Value (Property)	Tax Assessed Value (Land)	Total Assessed Value	Deferred Maintenance
Highway Building Annex	101 E. Morgan St.	$5,842,821	$13,315,971	$32,525,849	3,085,290
Highway Building	1 S. Wilmington St.	$12,860,490			2,110,400
DOT-Parking Deck	11 S. Wilmington St.	$506,567			
Agriculture	2 W. Edenton St.	$8,067,198	$8,812,079	$27,294,566	$36,021,310
Agriculture Annex	102 N. Salisbury St.	$7,597,717			30,044,300
Labor	4 W. Edenton St.	$2,712,434			2,162,420
Service Garage	0 W. Edenton St.	$105,138			
DOJ	114 W. Edenton St.	$21,878,982	$23,237,840	$107,500,554	277,550
Nature Research Center	121 W. Jones St.	$39,560,748			901,550
NRC-Parking Deck	121 W. Jones St. A	$7,421,238			
DOA-Parking Deck	120 W. Edenton St.	$15,401,746			
Old Revenue	2 S. Salisbury St.	$11,016,753	$4,112,334	$15,129,087	15,535,000
Justice	2 E. Morgan St.	$8,961,247	$2,154,094	$11,115,341	6,434,090
Court Of Appeals	1 W. Morgan St.	$4,401,515	$2,154,094	$6,555,609	$2,241,850
TOTALS		**$146,334,594**	**$53,786,412**	**$200,121,006**	**$98,813,760**

Notes: The Highway Building is owned by the Department of Transportation. DOT stands for Department of Transportation. DOJ stands for Department of Justice.

Source: Program Evaluation Division based on a review of Wake County real estate records and data provided by DOA.

To achieve best value, a systematic process should be undertaken to determine whether to sell or lease a state-owned property. Certain activities should be performed at an aggregate level to better manage all state properties; additionally, other activities should be done at a facility level to develop the detailed economic analysis for individual properties. At a minimum, this systematic process should include the following tasks:

<u>Better Manage All State Properties</u>

- **Maintain an Inventory of Government-Owned Properties.** DOA is statutorily responsible for maintaining a complete and accurate inventory database of all buildings owned or leased (in whole or in part) by the State or by any state agency.[6] Accurate information for each facility will help ensure any required analysis, including estimation of fiscal impact, consideration of future opportunities, and selection of the best private sector partner, produces useful information.

  As previously reported by the Office of the State Auditor and the Program Evaluation Division, and most recently in a contracted facilities assessment, the current inventory of state-owned property is inaccurate. A recent study of state-owned facilities recommended that the State modify or replace its current real estate database in

[6] N.C. Gen. Stat. § 143.341(4).

order to be compliant with the statutory requirement to maintain a complete and accurate inventory of state-owned facilities.[7]

- **Categorize Properties by Current Use and the State's Goals for Future Use.** Defining a property's highest and best use ensures property ownership and management plans are consistent with the State's overall goals and strategies.
- **Develop and Maintain Policies Regarding Disposition of Property.** To help ensure the sale or lease of a state-owned property results in the expected return on investment, policies and procedures should ensure fairness, transparency, and accountability.
- **Assemble a Strong Team to Evaluate Alternatives.** An executive team comprised of key stakeholders is critical to ensuring that the best alternative for a state-owned facility is chosen. The executive team should include representatives from both the executive and legislative branches. In addition, the executive team should have access to support services that can provide necessary expertise including finance, legal, economic development, and property management, as appropriate. Outside expertise may be necessary to augment unmet staff skills.
- **Determine How Any Sale or Lease Proceeds Will Be Used.** A decision on the appropriate use of the proceeds should be included in any decision to sell or lease a state-owned facility. The disposition of net proceeds may be used to gain access to capital, develop capital assets, provide services more efficiently, or provide large infusions of cash to help fund other state priorities.
- **Monitor, Communicate and Report Results of Sale/Lease Activities**. This task includes post-transaction monitoring and due diligence, analysis of performance, and communication to elected and appointed officials.

Economic Analysis and Sale/Lease Process

- **Perform an Economic Analysis.** The fair value of the state-owned facility should be determined by a third party using acceptable appraisal methods. The evaluation should consider opportunities for the optimal use of the property and the fiscal impact associated with a change from tax-exempt to taxable status. The economic analysis should also consider current revenues obtained by the government from the property, a forecast of anticipated future revenues under private ownership, current expenses incurred by the government, and future expenses, if any, under private ownership. Analysis should include an evaluation of the property's suitability for development, and whether the proposed project may spur additional development. Finally, the impact of upcoming regulatory requirements, lifecycle costs, and revenues should also be considered in connection with any economic analysis.

[7] CBRE, Inc. (2017, May). *Real Property Assessment Services*. Prepared for the State of North Carolina.

Typical real estate appraisals will include comparisons to other properties in the marketplace from two perspectives: recent, comparable purchases and current comparable property imputed rent values. Imputed rent is an estimate of the rent a property owner would be willing to pay to rent the building or land. The resulting imputed rent for each identified facility is an estimate of the value to the property owner and can then be compared with the rent of another suitable facility. For example, if the State can rent a similar property for less than the imputed rent of a state-owned property, it provides an indication that selling or leasing the state-owned facility and transitioning employees to a leased facility may be in the State's economic interest.

Another indicator that is useful when performing an economic analysis is the facility cost index (FCI). The FCI is a ratio of the value of current facility deficiencies to the current value of the facility. The FCI helps in making a determination of the recognizable sale value from a facility, given the cost to bring the building to applicable standards and address any deferred maintenance and repairs.

- **Define Required Legal Steps.** Ensuring the State has the authority to sell or lease is one of the initial tasks. Steps to consider include ensuring there are no statutory limitations affecting the effective achievement of any property sale or lease alternative, advertising, and conducting public hearings. Consideration should be given to establishing an appropriate balance of confidentiality to maintain the best negotiating position while remaining open and transparent to the extent possible.
- **Determine Whether Sale or Lease is the Best Arrangement.** Lease of property is appropriate when the State wishes to retain ownership but determines that transferring the responsibility for the operation of the facility would provide the best value. Leasing entails a careful assessment of the appropriate balance of risk and reward between a government owner and a private sector operator. When leasing, the State needs to ensure that agreements address required maintenance levels by the private sector.
- **Undertake a Competitive Process for Sale or Lease of the Facility.** To help ensure that the State achieves best value a competitive bidding process should be used when transferring any of the State's rights and responsibilities for a state-owned property. Interested parties should be required to submit proposals for evaluation. Proposals should include a concept plan for any intended development, qualifications and experience of the proposer/developer, a business plan for the project, financing plan, an anticipated time schedule for development, and evidence of financial strength and viability of investors
- **Establish and Weight Criteria to Evaluate Competing Offers.** The factors used to evaluate proposals from private entities regarding the sale or lease of state-owned property may include: monetary remuneration, long-term fiscal impact, proposed use, historic preservation, qualifications and experience of the development

team, and compatibility of a proposed use with comprehensive and neighborhood plans and current zoning.

- **Develop Agreements for Sale/Lease of Property.** In addition to the development of an appropriate sale or lease agreement, a performance agreement should be developed if appropriate. A performance agreement protects the State's interests by ensuring the private developer executes the sale or lease as agreed. A performance agreement is of particular necessity when properties are transferred for amounts below market value. Performance agreements can address items such as required minimum investment, jobs created (during construction and upon commencement of operations), and tax and/or other revenues generated. Such agreements should establish milestones for delivery/performance and include reversion provisions or monetary penalties in the event of non-performance.

To help ensure the success and minimize the risk of any transition of the rights and responsibilities of a state-owned property, a two-phase process should be performed. Phase 1 of this initiative should be the development of a business case to identify and evaluate the merits of the state-owned facilities that should be considered for sale or lease to a private entity. This phase should also include consideration of various alternatives that could be pursued, including renovation of the facility, so that the State ensures it is achieving the best value. Each alternative should be evaluated based on the projected time and costs to complete as well as expected revenues. The evaluation should also address any impacts on achievement of the State's goals and objectives. Based on these results, the General Assembly can then decide whether it is warranted to proceed to Phase 2 of the initiative.

Phase 2 of an initiative to transfer rights and responsibilities of a facility to the private sector or renovate the facility and assign additional employees to the facility would begin with authorization to initiate implementation of the selected alternative.

In summary, the Department of Administration manages office space utilized by state employees to perform their assigned duties. DOA may be able to reduce the State's facility management costs and help increase state agency performance by transitioning employees from high-value state-owned facilities to lower cost leased facilities. However, the decision to sell or lease a state-owned property should include consideration of various factors and processes.

Recommendation 2: The General Assembly should direct the Department of Administration to evaluate alternatives to reduce facility management costs and generate additional revenue through more effective use of state-owned and leased office facilities.

As discussed in Efficiency Opportunity 2, state agencies and their employees currently utilize state-owned facilities in high-value locations. In some instances, these employees may be transitioned to a lower-cost leased facility without adversely impacting operational performance. Transitioning employees from high-value state-owned facilities to lower-cost leased facilities can enable the State to realize either one-time infusions of funds or recurring revenues depending on whether the state-owned facilities are sold or are leased for an amount greater than the associated cost of leasing space for the transitioned employees.

To help ensure the State is cost-effectively meeting the facility requirements of state agencies and their employees, the General Assembly should direct DOA to evaluate alternatives to reduce the overall cost to house state employees while ensuring the facilities to which employees are transitioned effectively contribute to the State's goals and objectives. These alternatives should include moving state employees from leased facilities to a state-owned facility and transitioning employees from state-owned office facilities to a leased facility to generate revenue from state-owned office space through sale or lease.

The initial phase of this assessment should be limited to the state-owned office properties identified in Exhibit 4 and listed below:

- the Highway Building at 1 S. Wilmington St.,
- the Highway Building Annex at 101 E. Morgan St.,
- the Agriculture Building at 2 W. Edenton St.,
- the Agriculture Annex at 102 N. Salisbury St.,
- the Labor Building at 4 W. Edenton St.,
- the NC Department of Justice Building at 114 W. Edenton St.,
- the Old Revenue Building at 2 S. Salisbury St.,
- the Justice Building at 2 E. Morgan St., and
- the Court of Appeals Building at 1 W. Morgan St.

At a minimum, the evaluation of each of these state-owned office facilities should include consideration of:

- imputed rent of the state-owned facility,
- assessed value of the state-owned facility,
- estimated deferred maintenance and repair costs,
- time and cost to transition the state-owned facility to the private sector, if applicable,
- availability and cost of adequate leased property,
- number of net square feet per designated position,
- estimated time and cost to achieve designated space standards,
- specific requirements of each designated position,
- office moving costs,
- impact on employee commuting requirements,
- state agency office space requirements,
- impact on local government tax receipts, if applicable, and
- impact on state-owned parking facilities.

Division: Facility Management

Division Description: The Facility Management division is responsible for maintenance and service to the buildings owned and operated by the State of North Carolina.[8] The mission of Facility Management is to provide a safe and healthful work environment for employees and the general public in a cost-effective and energy-efficient manner. This mission is accomplished by performing routine, preventative, and emergency maintenance to state-owned facilities allocated to the Department of Administration. Facility Management also provides services for renovations and other requests.

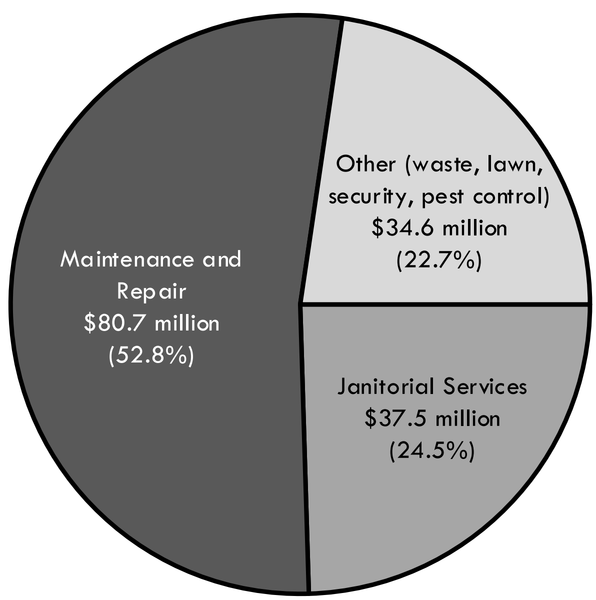
The Facility Management division is responsible for the maintenance of 169 state-owned facilities with a total of 5.8 million net square feet. In Fiscal Year 2016–17, Facility Management was authorized 154.3 full-time equivalent positions and expended $30.9 million

Efficiency Opportunity 3: Utilization of contracted services to perform additional facility management services on state-owned facilities

As shown in Exhibit 7, in Fiscal Year 2016–17, $152.8 million was expended to ensure the operability of state-owned facilities. Over half of this amount ($80.7 million) was associated with facility maintenance and repair activities. Janitorial services, which involve cleaning and basic maintenance duties, accounted for nearly a quarter ($37.5 million) of total facility management expenditures. Services accounting for the remaining $34.6 million in expenses included waste removal, lawn and grounds maintenance, security, and pest control services.

Exhibit 7

In Fiscal Year 2016–17, Facility Maintenance and Repair Activities Accounted for More Than Half of the $152.8 Million Expended to Ensure Operability of State-Owned Facilities



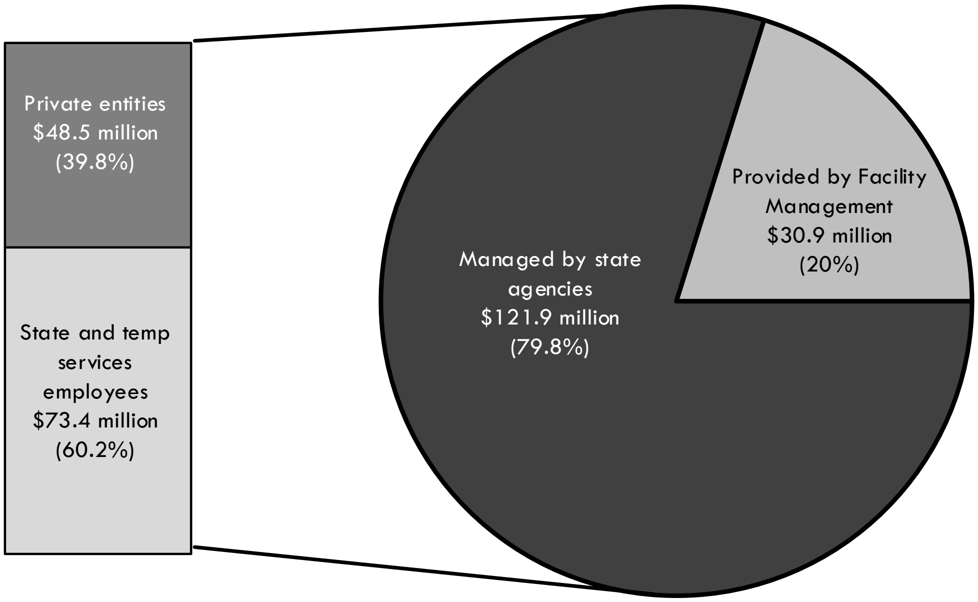
Source: Program Evaluation Division based on data provided by DOA.

[8] N.C. Gen. Stat. § 143-341.

Services provided by the Facility Management division accounted for only 20% of the $152.8 million expended to ensure the operability of state-owned facilities. The Department of Administration is responsible for providing facility management services for the maintenance of 169 state-owned facilities. As shown in Exhibit 8, DOA's Facility Management division accounted for only $30.9 million (20%) of facility management expenditures for state-owned buildings in Fiscal Year 2016–17. Nearly $28.5 million of this $30.9 million (92%) was utilized to fund staff and associated support services, with the remaining $2.4 million expended on contracted services. In Fiscal Year 2016–17, Facility Management was authorized 154.3 full-time equivalent positions. The services provided by Facility Management staff were primarily associated with facility maintenance and repair activities, whereas contracted services included janitorial, maintenance and repair, waste removal, and lawn and grounds services.

In Fiscal Year 2016–17, state agencies directly managed $121.9 million of the $152.8 million (79.8%) in total expenditures for facility management services. These agency-directed services were performed by state agency staff and through contracts with private entities. As also shown in Exhibit 8, costs associated with assigned agency staff and temporary services employees accounted for $73.4 million of this $121.9 million (60.2%) in state agency-administered expenditures. The remaining $48.5 million was utilized to procure facility management services from private entities. For example, the Department of Transportation reported that it has 72 contracts totaling $10.2 million to perform janitorial services at road-side rest areas.

Exhibit 8: In Fiscal Year 2016–17, Services Provided by the Facility Management Division Only Accounted for 20% of the $152.8 Million Expended to Ensure Operability of State-Owned Facilities



Source: Program Evaluation Division based on information from the North Carolina Accounting System, the Office of State Human Resources' Payroll System, and data provided by DOA.

In Fiscal Year 2016–17, $116.9 million was expended on energy services for state agencies. Energy service expenditures include costs to procure energy from various sources such as electrical, natural gas, coal, and steam. In addition, state-owned facility energy costs included costs associated with water, sewer, and stormwater services.

Provisioning of services by state agencies limits the ability of the Department of Administration to effectively achieve the mission of the Facility Management division. Facility Management has no process to coordinate services controlled by state agencies to ensure that services are cost-effectively contributing to the State's goal of providing a safe and healthful work environment for employees and the general public, or to centrally procure contracted services to obtain volume discounts. Consequently, the types and levels of services performed by state agency staff or through contracted entities may not consistently reflect requirements for each state-owned facility.

Variations in the level of services provided by state agencies limits the ability to monitor and evaluate performance against established benchmarks. For example, a common efficiency measure for janitorial services is cost per net square foot of space maintained. However, due to a lack of information pertaining to the work requirements of agency-administered janitorial services, DOA cannot determine whether these services are cost-effectively contributing to Facility Management's mission.

Also, due to the decentralized administration of these services, the State cannot realize potential cost savings associated with the ability to leverage the volume of statewide purchases to obtain lower prices.

A recent business case analysis of the Facility Management division found numerous obstacles and risks that may adversely impact the effectiveness and efficiency of its operations.[9] Specifically, the business case determined that:

Processes are not documented:

- Facility Management does not have a policies and procedures manual.
- Not all work orders are captured in current tracking and reporting software (TM2).
- Work order requests are manually recorded and are heavily reliant on phone calls to create new requests.
- Work order request prioritization is subjective.
- The TM2 system is only operational during normal business hours, which requires staff to track work orders outside the system if any are created during "off" hours.
- Projects involving multiple shops (e.g., HVAC and electrical) require separate work orders to request and complete.
- The division follows an unwritten policy that two staff are assigned to each work order regardless of need or severity.

Systems are outdated:

- The current work order tracking and reporting software (TM2) was implemented in 2001. The Facility Management division reported that this system is heavily reliant on a multistep paper trail and represents a bottleneck that could be alleviated by replacing it with newer software and practices. The most recent cost estimate to replace the current TM2 system is $173,180, with a recurring annual expense of $129,901 for usage rights and support of the new software.
- TM2 system support requirements are unique, making it difficult to recruit qualified staff as required.

Current approach to maintenance is "run to fail" and responding to "the latest crisis":

- Facility Management does not have a preventative maintenance program to help mitigate risks for equipment failures.
- Supervisors historically have operated in a reactive mindset ("What is the crisis today?").
- Facility Management does not have a capital plan to predict maintenance needs or related spending requirements.

Staffing—specifically talent attraction, retention, and turnover—is a major challenge:

- Facility Management does not have expertise in facility energy management resulting in a limited capability to realize potential building energy efficiencies.
- The division is unable to hire staff with proper skills within current pay rate or budget parameters.

[9] JLL. (2017, April). *Facilities Maintenance Management Assessment*. Prepared for State of North Carolina, Department of Administration, Facility Management Division.

- No succession plans are in place and approximately 50% of supervisors are currently eligible for retirement.
- Staff lack knowledge of the procurement process and purchasing rules.

The State of Tennessee reported annual savings of $5 million from implementation of a single source contract for facility management services. Prior to implementation of a single source contract, Tennessee utilized state employees to perform facility management services. Tennessee reported many of the same issues as North Carolina that were adversely impacting the efficiency and effectiveness of its operations. Specifically, Tennessee reported:

- lack of a preventative maintenance program to mitigate risks for equipment failures,
- insufficient maintenance practices led to energy-inefficient facilities,
- lack of proper training resulted in higher operating costs, and
- inability to self-perform regular daily repairs resulted in unnecessary delays, problems, and costs.

In response, Tennessee entered into a performance-based contract with a professional facilities management services provider to manage its state-owned office facilities, which comprise 6.8 million gross square feet.[10] These services included all facility management functions that would typically be contained in a facility lease such as:

- interior and exterior cleaning,
- unarmed security,
- furniture, fixture, and equipment maintenance and repair,
- management of furniture warehousing contracts,
- landscape maintenance and grounds care,
- refuse removal,
- vermin and pest control,
- snow and ice removal,
- parking control,
- preventative and remedial maintenance and repair of all systems and structures, and
- supply of all facilities-related consumables.

In addition, the contractor is required to:

- implement and maintain a call center to receive all service requests and complaints;
- develop, implement and manage a long-term preventative maintenance program designed to maintain each facility and its equipment, fixtures, and contents throughout its useful life;
- as requested, provide move management, project management, pre-planning, occupancy planning, shipping and receiving/dock management, food service operations, administrative site services, special events set-up and coordination, master planning, and facility assessment, based on established rates and charges;

[10] Gross square feet is the area including all enclosed space as measured from the exterior face of building walls.

- develop, implement, and manage an efficient and cost-effective recycling program at each facility that meets or exceed all local, state and federal requirements;
- conduct on-site inspections each calendar quarter (at a minimum) of state-owned and leased facilities of greater than 20,000 square feet and on-site inspections annually (at a minimum) at leased facilities of less than 20,000 square feet, and provide assessments of all factors pertinent to each facility; and
- schedule, coordinate, supervise, and manage subcontractors performing minor move-ins, move-outs, and individual office relocations.

Tennessee's contract for these services includes financial performance incentives. To help ensure achievement of Tennessee's goals and objectives for facility management, the contract includes key performance indicators based upon objectives and measurable criteria. The contract stipulates that up to half of the management fee for these services is based on results achieved during the previous year for each performance indicator. Performance incentives ensure the risks and rewards associated with achievement of the State's goals and objectives are shared and the State obtains the best value for these services.

Tennessee reported that implementation of this single-source facility management contract resulted in savings of $13 million in its first two years, including $2.1 million in energy savings, coupled with a steady rise in customer satisfaction. Projected total cost savings from this initiative are estimated to be $50 million over the life of the contract. This level of cost savings is expected to be realized by changes in four specific areas:

1. **Procurement Leverage**. The service provider has implemented multi-year contracts with subcontractors under standard terms and conditions that have delivered significant savings to the State.
2. **Improved Training/Skills**. Another key benefit delivered by the service provider is the development of training programs. Prior to engaging with a professional facilities management service provider, Tennessee frequently subcontracted tasks that required skilled resources, as state employees did not possess the skills and certifications needed to perform the work. The training programs instituted by the service provider have created a broader-skilled facilities management workforce. The contract Tennessee entered into with the provider stipulated retaining many former state employees, and as a result of their employment with the contractor, these employees have gone through hours of training and have earned certifications they did not previously possess. An additional benefit of this training is that it increased the value of these employees in the marketplace and contributed towards greater compensation for their jobs. Overall, retained state employees are paid 28 percent more than they were as state employees. Ten percent of that amount represented adjustments for differences in benefits but the other 18 percent far exceeds normal pay increases experienced by most employees in that time period.

3. **Optimized Staffing.** Prior to engaging a professional services provider to manage Tennessee's real estate portfolio, the State relied upon a large number of subcontractors to perform work (e.g., painters, plumbers, roofers, electricians). The professional facilities management provider has trained employees in its own workforce to provide these services, allowing these resources to be allocated across state buildings as needed.
4. **Labor Savings.** Prior to working with a professional facilities management service provider, Tennessee used 129 employees to perform facilities management tasks across its buildings. In many cases, each building had dedicated resources. The professional facilities management service provider aggregated the management of multiple facilities under fewer managers while still improving service levels.

In 2017, the State of Tennessee expanded its single-source contract for facility management to all state entities including the university system. Agencies and institutions are authorized to choose whether or not to utilize the contract for services and are allowed to retain the savings achieved. For facilities managed by the university system, cost savings associated with lower payments to the service provider than are currently experienced in actual costs are redirected at the discretion of the individual campuses and higher education systems. For facilities managed by state agencies, the savings result in lower "rent" for the agency. Each agency is responsible for redirecting funds for purposes that benefit the implementing agency's mission, subject to approval by the budget office according to normal procedures.

Establishment of a single source contract for facility management services in Tennessee is one of several ongoing initiatives relating to property management. The single source contract for facility management services is one of four ongoing initiatives under the State's Strategies for Efficiency in Real Estate Management (SEREM) project. These four ongoing initiatives are:

1. **Facilities Management:** Increase service and lower costs to state facilities through performance management contracting.
2. **Alternative Workplace Solutions:** Increase workforce productivity while reducing real estate needs and costs through flexible schedule and workspace options.
3. **Real Estate Process Improvement:** Lower contracting costs by streamlining real estate processes related to construction, leasing, acquisition, and other property management activities.
4. **Energy Management:** Reduce energy costs by improving energy efficiency in state facilities.

A Project Management Office oversees all four initiatives and each individual initiative has its own project director and Steering Committee. The day-to-day management of the Project Management Office is housed in the Department of Finance and Administration's Office of Customer Focused Government. The Facility Management Steering Committee is comprised of a cross-section of stakeholders with representation from the legislative and executive branches.

To ensure North Carolina's General Assembly has the necessary information to determine whether to pursue a single-source contract for the management of state-owned facilities, a business case analysis should be performed. The business case development process is performed in conjunction with the sourcing evaluation phase of a procurement. The objective of the sourcing evaluation phase of the procurement process for services is to identify the method of delivery that will provide the best value to the State. An effective sourcing evaluation phase is critical to the success of the entire procurement process because the information obtained during this phase is essential for the subsequent contract formation and contract management phases to effectively contribute to achievement of intended outcomes.

Activities associated with the business case development process for a contracted service should include:

- identification of available service delivery options, including delivery in-house, provision by other governmental units, contracts with non-profits, and contracts with for-profits;
- development of complete and reliable cost, benefit, and performance data including the costs associated with the contract formation and management phases of the procurement process; and
- analysis of the market for the service to include consideration of any limitations on the use of a competitive bidding process to select a provider and incentives to ensure achievement of intended outcomes.

Staff assigned to the business case development process should ensure that a team of people is available to perform each of these activities. In addition to having staff with extensive knowledge of the service operation, the team should be able to employ staff with specific expertise as necessary. Participation in this phase of the procurement process by a wide range of professionals helps ensure that any potential issues will surface in the early stages and can be dealt with before the service is solicited from the private sector.

A business case analysis for determining the most cost-effective delivery of facility management services for state-owned facilities should also include an evaluation of the following associated services and activities:

- call center/customer service center;
- building operations, including, but not limited to:
  - janitorial/custodial,
  - maintenance and repair,
  - pest control,
  - lawns and grounds,
  - waste removal/recycling,
  - road clearance, and
  - unarmed security services;
- preventative maintenance;
- subcontractor management for services not self-performed;
- facilities-related purchasing;

- safety and emergency preparedness and disaster recovery plans/support;
- energy management/utilities analysis;
- financial services and accounting related to building operations, to include
  - accounts payable and integration with the State's enterprise-level accounting and human resource management systems,
  - cost management and budgeting (operating and capital), and
  - comprehensive financial reporting; and
- comprehensive operational reporting.

A key component of the business case justification process is establishing the current baseline cost. Establishing baseline cost would allow for a more accurate determination of the potential cost savings that could be realized from entering into a single-source contract for facility management services. To determine baseline cost there are several variables that must be specified for each facility. These variables include:

- the type of space and square footage of that space;
- the types of services being performed in that space, i.e. janitorial, security, waste removal;
- the level of service provided, determined by the individual tasks performed and the frequency with which they are performed; and
- the service category, service level, and cost expressed as $/Gross Square Feet, based on the facility type.

Once this information has been collected, the final step in establishing a current baseline cost is to total all of the benchmark costs for an agency or institution and divide them by the total square feet of that agency or institution to determine its cost per square foot. Projected cost savings can then be calculated by comparing these baseline costs with establish benchmark information. Tennessee used the Whitestone Cost Reference, an industry-recognized tool for benchmarking the cost of facility management and maintenance, to make this calculation. To provide greater assurances regarding the validity of the results presented in the business case, the State could choose to request that a third party validate the associated cost analysis and other pertinent factors.

As with any initiative to contract for services, consideration should be given to ensuring that there will not be a disruption in the service due to non-performance by the vendor. To help mitigate the risk of a service disruption or inadequate performance, the decision to contract with a private entity should consider the availability of a sufficient number of qualified private service providers as a condition of the outsourcing alternative. The availability of a sufficient number of qualified service providers helps ensure that competitive bidding can be effectively used in the procurement, and that the service provider cannot engage in monopolistic behavior by raising prices and reducing quality over time.

In summary, in Fiscal Year 2016–17, over $152.8 million was expended to ensure the operability of state-owned facilities utilized by state agencies. State agencies directly managed $121.9 million (79.8%) of these expenditures. Agency-directed services were performed by state agency staff and through contracts with private entities, limiting the ability of the

Department of Administration to monitor and evaluate performance or fully realize potential cost savings. A contracted business case analysis of the Facility Management division identified numerous systematic deficiencies that may be adversely impacting the effectiveness and efficiency of its operations. The State of Tennessee recently established a single source contract for facility management services that is projected to save over $50 million over the life of the contract. A similar initiative may achieve comparable savings in North Carolina. As a condition of the General Assembly authorizing the establishment of a single-source contract for facility management services in North Carolina, a business case analysis should be performed that includes consideration of all relevant activities and services.

Recommendation 3. The General Assembly should direct the Department of Administration to perform a business case analysis of facility management services performed on state-owned property.

As discussed in Efficiency Opportunity 3, in Fiscal Year 2016–17, over $152.8 million was expended to ensure the operability of state-owned facilities utilized by state agencies with agencies themselves directly administering $121.9 million of these expenditures. A study of DOA's Facility Management division identified numerous systemic deficiencies that may be adversely impacting the effectiveness and efficiency of its operations.

The General Assembly should direct DOA to perform a business case analysis of facility management services performed on state-owned property. The objective of the business case should be to explore ways to improve facility management services within the State's real estate portfolio at a lower cost. The scope should include exploring whether there is potential for savings through expanded use of contracted facility management services.

The results of the business case analysis should provide sufficient information to enable a Best Value procurement that results in the establishment of a Government-Vendor partnership contractual agreement.[11] Specifically, the business case should ensure that any recommended alternative that includes additional utilization of professional facility management services incorporates an outcome-based model that ties supplier payments to mutually agreed boundary-spanning business outcomes where there is shared risk and shared reward.

For each identified service pertaining to facility management services, in addition to the requirements outlined in Recommendation 13 of this report,

[11] As specified in N.C. Gen. Stat. § 143-135.9, a Best Value procurement results in the selection of a contractor based on a determination of which proposal offers the best trade-off between price and performance, where quality is considered an integral performance factor. The award decision is made based on multiple factors, including: total cost of ownership, meaning the cost of acquiring, operating, maintaining, and supporting a product or service over its projected lifetime; the evaluated technical merit of the vendor's proposal; the vendor's past performance; and the evaluated probability of performing the requirements stated in the solicitation on time, with high quality, and in a manner that accomplishes the stated business objectives and maintains industry standards compliance.
As specified in NC Gen. Stat. § 143-135.9 (a) (2), a Government-Vendor partnership is a mutually beneficial contractual relationship between state government and a contractor, wherein the two parties share risk and reward and value is added to the procurement of needed goods or services.

the business case analysis of ways to improve facility management services should also include:

- level of service provided at each applicable facility;
- unit and total cost of performing the service at each applicable facility for the most recently completed fiscal year;
- estimated cost to perform the service under a single source contract;
- cost and description of alternatives to mitigate impact on the current employees performing facility management services;
- proposed set-asides for minorities and persons with disabilities, as applicable;
- identification of roles, organizational placement, responsibilities, and qualifications of key project team members, to include demonstrated competency incorporating government-vendor partnerships into the procurement process (the project team should include an executive management steering group and an advisory council consisting of members from the public and private sector, that together possess the requisite expertise to ensure effective implementation of the recommended alternative); and
- an implementation plan for the recommended alternative, to include funding requirements and associated funding sources for the proposed contract period, and a service delivery transition process, to include a schedule of procurement milestones and associated funding requirements.

Division: Purchase and Contract

Division Description: The Division of Purchase and Contract is the central procurement authority that oversees purchasing for all state entities. Specifically, state law directs the Division to canvass sources of supply and to purchase or contract for the purchase, lease, and lease-purchase of all goods required by the State or any of its departments, institutions, or agencies under competitive bidding or other suitable means, as authorized by the Secretary of the Department of Administration.[12] The objective of the procurement process for all goods and services purchased by the State is to obtain best value. As specified in statute, the intended result of a best-value procurement process is the selection of a vendor that will provide the best trade-off between price and performance, where quality is considered an integral performance factor.[13]

To achieve this objective, the Division of Purchase and Contract establishes state term contracts, which establish suppliers and prices for selected goods and services for a period of time without guaranteed purchase quantities. The Division also approves awards for contracted services. In addition, Purchase and Contract provides training to procurement professionals and vendors, technical assistance on specifications and qualified products, compliance reviews, and inspections.

In Fiscal Year 2016–17, the Division of Purchase and Contract administered 58 state-term contracts with expenditures exceeding$1.31

[12] N.C. Gen. Stat. § 143-49 (1).
[13] N.C. Gen. Stat. § 143-135.9(a) (1).

billion. The Division authorized an additional 297 awards for contracted services totaling $223.6 million. Purchase and Contract was allocated 33.1 full-time equivalent positions and expended $2.5 million in Fiscal Year 2016–17.

Efficiency Opportunity 4: Increased compliance with state-term contracts

One of the primary objectives of the state term contracting process is to achieve increased value from the goods and services purchased by state agencies. This objective is achieved by leveraging the volume of statewide purchases of selected goods and services to obtain lower prices. State term contracts, which are statutorily required to be utilized by all state agencies for purchases of applicable goods and services, consolidate typical requirements of all agencies into one agreement.[14] Vendors are encouraged to provide lower costs in exchange for assurances that all state agencies purchasing the associated goods or services will use the selected vendor. Any associated reductions in profit margin would therefore be mitigated by increased purchase quantities.

In addition to providing increased value for purchased goods and services, the state term contracting process can also serve to improve the efficiency of state agency procurement. State agencies can avoid a prolonged procurement process and reduce procurement costs for commonly purchased goods and services by utilizing state term contracts. Hence, both agencies and potential vendors are able to avoid costs associated with competitive bidding requirements.

For the state term contracting process to be effective, vendors and the State need assurances that state agencies will solely utilize selected vendors. Documented sales volumes and high compliance rates allow vendors to confidently calculate competitive state term contract bids. To maximize cost savings, the Division of Purchase and Contract needs assurances that agencies are utilizing state term contracts to purchase all applicable goods and services.

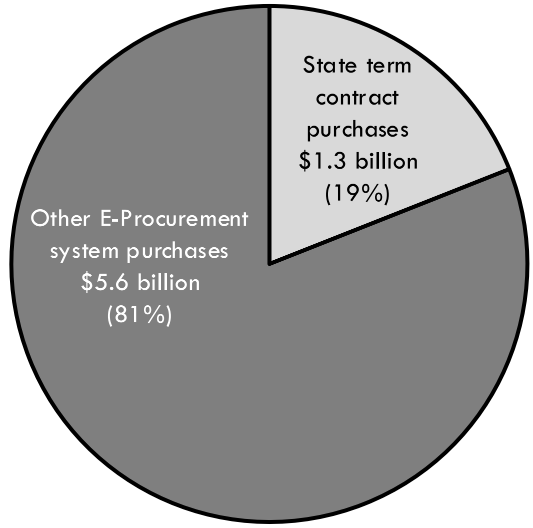
As shown in Exhibit 9, the Division of Purchase and Contract was able to identify state term contract purchases totaling $1.3 billion, which represents 19% of the nearly $7 billion expended through E-Procurement in Fiscal Year 2016–17. DOA asserted that although not all of the remaining $5.6 billion in purchases was subject to a state term contract, a portion of this amount includes noncompliant purchases of goods and services with an applicable state term contract.

State agencies procured an additional $1.79 billion in goods and services outside of the NC E-Procurement system. These purchases were made through utilization of a state purchasing card or a purchase order issued directly to the vendor.

[14] N.C. Gen. Stat. § 143-49 (1).

Exhibit 9

State Term Contract Purchases Accounted for 19% of the Nearly $7 Billion Expended Through E-Procurement System in Fiscal Year 2016–17



Source: Program Evaluation Division based on data provided by DOA.

Since 2010, the Department of Administration has issued contract awards totaling $79.5 million to improve the effectiveness of the state term contracting process. Specifically, DOA executed a contract for the transformation of the State's procurement functions. The initial contract had an estimated value of $2 million and was authorized by the Division of Purchase and Contract for award on November 10, 2010. As of June 30, 2015, DOA has executed seven modifications and increased the value by $77.5 million to $79.5 million.

The procurement transformation contract included a requirement to identify areas of greatest opportunity to strengthen the State's procurement capabilities and create savings opportunities. To meet this requirement, the vendor identified potential savings that could be realized through utilization of state term contracts. As shown in Exhibit 10, the vendor conducted an analysis of nine state term contracts and calculated total potential savings of $38.9 million, or an average 12.7% overall reduction in the cost of the associated goods and services.

Exhibit 10: Vendor Analysis of Nine State Term Contracts Determined Full Compliance Would Produce Nearly $39 Million in Savings

Contract	Savings %	Total Documented Spend	Total Documented Savings
Office Supplies- 615A	31.1%	$36,566,197.66	$16,511,107.54
Office Paper- 645A	9.3%	$10,693,534.38	$1,092,363.90
Lab Supplies- 493A	13.9%	$12,701,389.78	$2,044,117.95
MRO- 445B	13.2%	$22,291,672.00	$3,389,198.87
Diesel- 405B	7.1%	$55,385,560.32	$4,215,258.30
Gasohol- 405C	2.4%	$36,945,826.82	$901,322.04
Auto Parts- 060A	13.7%	$2,538,178.82	$403,766.35
Tires- 863A	11.5%	$37,213,444.16	$4,833,071.07
Vehicles- 070A	5.7%	$90,797,241.82	$5,488,274.43
Total	**12.74%**	**$305,133,045.76**	**$38,878,480.45**

Source: Program Evaluation Division based on data provided by DOA.

However, the Division of Purchase and Contract cannot determine whether these projected cost reductions were realized. The Division reported an inability to determine the full effectiveness of state term contracting due in part to a lack of necessary information. For example, the Division reported that accurate commodity code information for each transaction would assist in identifying noncompliant transactions and the associated unit cost of the good or service. Accurate commodity code information would allow the Division to determine if the transaction was subject to state term contracting requirements, as well as the difference in unit price from the amount specified in the state term contract.

Noncompliance with state term contracts for purchases of applicable goods and services reduces the cost savings agencies realize from these contracts. The Office of the State Auditor identified state term contracts with significant levels of non-compliance in a performance audit report issued in 2010.[15] Considering the volume of purchases made through the NC E-Procurement system, the audit found that Purchase and Contract monitoring procedures are not efficient or effective for detecting widespread noncompliance with the state term contracting process. For example, the audit reported that if agencies had used the applicable state term contract when purchasing automotive filters, the State would have saved $196,816, or 31% of total expenditures for these products in Fiscal Year 2008-09. Full compliance with the state term contract for battery purchases would have garnered $19,120 in additional cost savings, or 24% of total expenditures for batteries.

Additionally, the audit reported that the Division of Purchase and Contract does not capture and analyze overall reasons for noncompliance with state term contracts. Gathering and analyzing this information could assist the Division in identifying special types of goods or services that are not currently covered but should be included in future contracts due to overall

[15] Office of the State Auditor (2010, October). *Performance Audit—Department of Administration, Division of Purchase and Contract: State Term Contracting Process*. Raleigh, NC: General Assembly.

high purchase volume. These data could also assist in identifying agencies with unusually high noncompliance for a more focused analysis of individual agency procurement practices.

The audit report also included several recommendations to help ensure compliance with state term contracts. Specifically, the audit recommended that Purchase and Contract should consider utilizing system edits in the NC E-Procurement software. System edits can be set up to require state agencies to consider a state term contract vendor and to electronically capture reasons for any noncompliance. System edits can also ensure accurate procurement data is collected from state agencies that can be used to evaluate cost savings realized from the use of state term contracts. Ready access to documented reasons for noncompliance can improve monitoring of the state term contracting process. For example, this documentation can be used to identify goods and services appropriate for future state term contracts. Also, this information can be used to better allocate compliance monitoring resources to state agency procurements with indications of significant noncompliance or ineffective procurement processes.

DOA agreed with these recommendations to implement an electronic functionality that would require the user to request prior approval from Purchase and Contract for deviations from the state term contract. However, software enhancements would be required for this initiative to be effective.

As of March 2018, DOA had not implemented a process to help ensure and monitor compliance with state term contracts. Despite the expenditure of nearly $80 million to improve the State's procurement processes, the Division of Purchase and Contract reported that it is unable to determine state agency compliance with state contracting requirements. The Division also reported that it is unable to determine state term contract expenditures or total expenditures that are subject to state term contract requirements. For example, a state term contract for industrial and specialty gases is held by two vendors with whom state agencies spent a total of $4.1 million during Fiscal Year 2016–17. [16] However, only $1.7 million (41%) of those expenditures could be identified as contract-compliant. Short of manually examining the purchase orders representing the remaining $2.4 million spent with those two vendors, compliance status cannot be fully determined.

The Purchase and Contract Division reported that it recognizes the inability to determine the amount of non-compliant spending interferes with its efforts to properly leverage its position when obtaining new contracts as well as causes additional cost to the State for goods purchased. The Division is currently working to address the issue of non-compliant spending both from an education and training perspective and through its efforts to acquire more capable technology.

The Division also reported that as of January 2018 the NC E-Procurement system does not possess automated functionality to prevent a user from purchasing an item under state term contract from another source. Purchase

[16] As specified in State-Term Contract #430.

and Contract has investigated various methods of adding or working around the lack of this functionality as was recommended by the Office of the State Auditor, but all potential solutions have proved prohibitively expensive or highly resource-intensive. Purchase and Contract is currently working with the Department of Information Technology to address this issue in its next system upgrade. DOA also reported that Purchase and Contracts instructs users to utilize the comments field in the E-Procurement system to document reasons for deviations from a statewide term contract. However, this field is limited to open-ended text entry, so no easy method exists to determine which reasons are cited most frequently.

Regardless, preventing violations of state term contracting requirements is a more cost-effective way to ensure compliance than trying to detect non-compliant transactions. Preventing non-compliance outright better ensures that the savings associated with utilization of a state term contract will be realized. As a result, the performance audit conducted by the Office of the State Auditor recommended exploring potential changes to the NC E-Procurement software that would facilitate state term contract monitoring and improve compliance.

Effective monitoring of state term contracts is more problematic for purchases that are processed outside of the NC E-Procurement system. Often, the Division of Purchase and Contract can only monitor these purchases after the transaction has been recorded in the State's accounting system (NCAS). Further complicating the issue, items subject to state term contract requirements are difficult to identify in NCAS. Consequently, it may be more cost-effective to limit the types of purchases that can be processed outside of the NC E-Procurement system. For example, the Office of the State Controller could restrict P-card usage to employee travel expenses and office supply catalog purchases by designated employees. In addition, increased oversight of the associated transactions is required to ensure compliance with state term contracting requirements.

In summary, the development and utilization of state term contracts involves leveraging the volume of statewide purchases of selected goods and services to obtain lower prices and consequently helps to achieve increased value from the goods and services purchased by state agencies. However, the State may not be realizing the full potential of the state contracting process because state agencies may not be fully complying with the state term contract usage requirements. Improved compliance monitoring and better collection and consideration of agency justifications for not using state term contracts can help realize additional cost savings from the state term contracting process.

Recommendation 4: The General Assembly should direct the Department of Administration to monitor enforcement of statutory compliance with state term contract utilization requirements by state agencies.

As discussed in Efficiency Opportunity 4, the development and utilization of state term contracts leverages the volume of statewide purchases of selected goods and services to obtain lower prices, thereby helping to achieve increased value from the goods and services purchased by state agencies. However, the State may not be realizing the full potential of the state contracting process because state agencies may not be fully complying with state term contract usage requirements. Improved compliance monitoring and better consideration of agency justifications for not utilizing state term contracts can help realize additional cost savings from the state term contracting process.

To ensure that the Department of Administration has sufficiently valid and reliable information to cost-effectively ensure achievement of the goals and objectives of the Division of Purchase and Contract, the Program Evaluation Division recommends the General Assembly direct DOA to develop a process to monitor and enforce compliance with state term contracting requirements for purchases of goods and services processed through the NC E-Procurement system. Specifically, DOA should be directed to establish electronic functionality in NC E-Procurement to monitor compliance with state term contracting requirements and force utilization unless specific justification is documented and approved by the Division of Purchase and Contract. In order to identify opportunities to improve the state term contracting process, this electronic functionality should also include the capability to effectively utilize the information provided by agencies when justifying non-utilization of a state term contract for an eligible transaction.

To help ensure compliance with state term contract utilization requirements, the General Assembly should also amend North Carolina General Statute 143-55 to require purchases of goods and services with an associated state term contract be made through the State's purchasing system, NC E-Procurement, and that utilization of other methods such as purchase cards and issuance of purchase orders outside of E-Procurement be prohibited except as specifically authorized by the Office of the State Controller.

In addition, the General Assembly should require that in conjunction with the procurement process for each state term contract executed after June 30, 2018, DOA should determine the expected discount from the applicable retail unit cost for each applicable good or service identified in each state term contract.

The Department of Administration should be directed to provide the implementation status of these recommendations to the Joint Legislative Oversight Committee on General Government and the Fiscal Research Division by December 1, 2018.

Efficiency Opportunity 5: More effective use of competitive bidding for contracted services

North Carolina law requires high-value services be procured through a competitive bidding process unless specifically waived by the Division of Purchase and Contract.[17] Division policy also specifies that competition to provide the service be reasonable and adequate for the amount of the expenditure.

[17] N.C. Gen. Stat. § 143-49(3).

Competitive bidding ensures achievement of best value from a contracted service. A competitive bidding process incentivizes prospective service providers to submit a proposal that will provide the most cost-effective service delivery. State agencies are then able to evaluate each proposal and select the service provider that can provide the best value.

State agencies are not fully utilizing a competitive bidding process to procure contracted services. An evaluation by the Program Evaluation Division of 133 high-value service contracts published in 2016 found that full competition was not utilized in the awarding of $511 million (41%) of the $1.24 billion awarded to private providers.[18]

The report identified three areas of the State's procurement process for contracted services that limited the effectiveness of a competitive bidding process to help achieve best value for the State. These three identified areas were:

- Division of Purchase and Contract-authorized waivers from the requirement to use a competitive bidding process,
- contracts awarded to several private providers from a single solicitation, and
- amendments to contracts.

Further review of these 133 high-value service contracts determined that as of February 2018, the Division had authorized 18 contract amendments to extend the period of time in which a service provider is authorized to expend funds totaling $56 million. In response to a request from the Program Evaluation Division, the Division of Purchase and Contract conducted a review of its files to identify the number and value of associated amendments to extend the contract period for the 133 high-value contracts awarded during the period October 22, 2009 through June 25, 2015, as identified in the Program Evaluation Division's 2016 report on contracted services. In response, Purchase and Contract identified 18 contracts with a total of 31 separate extensions to the original contract period. In total, these 31 contract extensions totaled $56.0 million. Contract extensions were also included as part of the $77.5 million in contract modifications to provide services for the transformation of the State's procurement functions.

State agencies should be required to request a reduction in the cost of the current contract as a condition of issuing a contract extension. Contract amendments may also document time period extensions for a service provider to expend funds. Extensions in the authorized time period to perform contracted services are awarded without the use of a competitive bidding process. As with contract amendments that change the level of service, there are often valid reasons for an extension in the contract period. For example, the cost to conduct a competitive bidding process and award a new contract may exceed the potential increase in value. However, this determination is often made without performing due diligence because of insufficient time and resources available to state agencies to conduct a complete and through analysis.

[18] Program Evaluation Division (2016, January). *Enhanced Oversight of Service Contracts Can Help Ensure Cost-Effective Performance.* Report to the Joint Legislative Program Evaluation Oversight Committee. Raleigh, NC: General Assembly.

In 2011, the Governor of Florida directed state agencies to request a 10% reduction in the prorated amount of the original contract award when considering authorization to extend the period of time to expend funds for contracted services. In every instance, the contractor agreed to a 10% reduction in lieu of being subjected to a competitive bidding process to award a new contract. North Carolina may be able to realize similar savings by requiring a 10% reduction in the original contract award amount as a condition of granting a contract extension without utilizing a competitive bidding process.

The Department of Administration has not implemented the recommendation by the Program Evaluation Division to purchase a contract management system. To help ensure that state agencies devote sufficient time and resources to determining whether to extend the period of time in which a service provider is authorized to expend funds or to award a new contract through a competitive bidding process, the evaluation of contracted services conducted by the Program Evaluation Division included a recommendation to procure and implement a contract management system for state agency-administered contracted services.

Utilization of a contract management system would allow the Division of Purchase and Contract to more easily identify when the current contract period will expire and to ensure agencies begin the process to determine if the contract should be extended while still having sufficient time to award a new contract through a competitive bidding process.

In its response to this recommendation, DOA reported agreement and developed a request for proposal to purchase a contract management system that would enable more effective monitoring of contracts. DOA also reported it expected to issue the request for proposal in January 2016. However, as of January 2018, DOA stated that it has not purchased the recommended contract management system and continues to work on developing requirements.

In summary, to help ensure achievement of best value, North Carolina law requires high-value services be procured through a competitive bidding process unless specifically waived by the Division of Purchase and Contract. However, as reported by the Program Evaluation Division report in 2016, state agencies are not fully utilizing a competitive bidding process to procure contracted services. One identified area of the State's procurement process for contracted services that limited the effectiveness of a competitive bidding process was the issuance of contract amendments to extend contract periods. Florida was able to obtain a 10% reduction in original contract award amounts as a condition of issuing contract extensions. North Carolina may similarly be able to realize savings by requiring state agencies to obtain a 10% reduction in annual cost from the original contract value as a condition of executing an extension.

Recommendation 5a. The General Assembly should direct the Department of Administration to procure and implement a contract management system for state agency-administered contracted services.

As described in Efficiency Opportunity 5, the Program Evaluation Division previously reported that the process for procuring contracted services does not ensure achievement of best value. Specifically, the Program Evaluation Division reported state management and monitoring of contracted services does not consistently contribute to effective performance.

To ensure the Division of Purchase and Contract and state agencies can effectively monitor and manage contracts to ensure compliance with applicable requirements and achievement of best value, the General Assembly should require the Division of Purchase and Contract to procure and implement a contract management system and require state agencies to manage a procurement process for all contracts for services.

State agencies should be required to utilize the contract management system for all contract awards issued after installation of the system. For contract awards issued prior to installation of the contract management system, state agencies should be authorized to use the existing legacy system to monitor contract expenditures but should be required to provide Purchase and Contract with the amount spent under each applicable contract for services during the preceding fiscal year, as well as any other information required to produce the annual report on state agency-administered contracts for services.

Recommendation 5b. The General Assembly should direct the Division of Purchase and Contract to require state agencies to obtain a 10% reduction from the annual value of the original contract as a condition of awarding an amendment to a contract that extends the period of time in which a service provider is authorized to expend funds.

As discussed in Efficiency Opportunity 5, to help ensure achievement of best value, North Carolina law requires high-value services be procured through a competitive bidding process unless specifically waived by the Division of Purchase and Contract. However, as the Program Evaluation Division reported in a previous evaluation of contracted services, state agencies are not always fully utilizing a competitive bidding process to procure contracted services. One identified area of the State's procurement process for contracted services that limited the effectiveness of a competitive bidding process was the issuance of contract amendments to extend contract periods.

To help ensure achievement of best value from contracted services, the General Assembly should direct the Division of Purchase and Contract, as a condition of awarding an amendment to extend the contract period, to require the value of a contract extension be reduced by at least 10% of the prorated value of the associated services under the original contract.

In those instances in which the current contractor does not agree to a 10% price reduction, Purchase and Contract should be required to direct the applicable state agency to award a new contract through a competitive bidding process. The decision by the vendor to accept this reduction in the annual contract value should be required to be made in a manner that is sufficiently timely to allow for a competitive bidding process for a new contract to be conducted prior to expiration of the current contract in instances in which the current contractor does not agree to the reduction. State agencies should continue to be authorized to submit a written justification for Purchase and Contract to waive the requirement to procure these services through a competitive bidding process.

Division: Motor Fleet Management

Division Description: The Motor Fleet Management division (MFM) was established in 1982 with the aim of lowering fleet costs through the elimination of duplication and inefficiencies caused by the decentralized management of state-owned passenger vehicles.[19] As specified in statute, MFM is required to establish and operate a central motor fleet and necessary support facilities.[20] The purpose of the division is to provide savings to the taxpayers of North Carolina by providing a low-cost, centralized source of passenger vehicles to state agencies and state employees in the performance of their duties. In conjunction, MFM operates a facility that contains an 11-bay garage for vehicle repairs and several acres of land for vehicle processing and assignment.[21]

Specifically, Motor Fleet Management is authorized to:

- establish and operate central facilities for the maintenance, repair, and storage of state-owned passenger motor vehicles for the use of state agencies,
- acquire passenger motor vehicles by transfer from other state agencies and by purchase, which shall be part of the central motor fleet, and
- allocate and charge against each state agency to which transportation is furnished, on a basis of mileage or of rental, its proportionate part of the cost of maintenance and operation of the motor fleet. [22]

As of June 30, 2017, the Motor Fleet Management division was responsible for managing 7,591 vehicles. During Fiscal Year 2016–17, the division sold 1,276 vehicles and purchased 1,402 vehicles. In total, vehicles managed by MFM were driven 83.2 million miles.

In Fiscal Year 2016–17, MFM was allocated 48 full-time positions and expended $49.5 million.

[19] Passenger vehicles are defined by administrative rule as any automobile sedan, station wagon, pick-up truck, four-wheel-drive utility vehicle, or passenger-type minivan. Vehicles performing functions other than passenger transport are excluded from centralized oversight by MFM.
[20] N.C. Gen. Stat. § 143-341(8)(i).
[21] The facility is located at 1915 Blue Ridge Road in Raleigh.
[22] As specified in N.C. Gen. Stat. § 143-341(8)(i), motor vehicles under the ownership, custody, or control of the State Highway Patrol, State Bureau of Investigation, or constituent institutions of the University of North Carolina that are used primarily for law enforcement purposes are exempt from the requirement to transfer vehicles to the central motor fleet.

Efficiency Opportunity 6: Effective use of telematics data

Telematics offers a cost-effective solution to improve accountability and provide complete vehicle utilization information. By integrating wireless communications, vehicle monitoring systems, and GPS location devices, telematics provides complete vehicle utilization data, identifies and confirms misuse, reduces reliance on state agencies, and promotes more efficient vehicle utilization. In a 2012 report, the Program Evaluation Division found that implementation of basic telematics services could be cost-effective due to estimated reductions in vehicle utilization, and that the General Assembly should direct the Department of Administration (DOA) to install basic telematics services on state-owned passenger vehicles.[23]

Specifically, effective use of information from telematics can help Motor Fleet Management reduce costs and improve performance in the following areas:

- improved driving behavior achieved through reductions in fuel consumption and number of accidents,
- more efficient route planning,
- optimized vehicle inventorying,
- higher resale value achieved through improved preventative vehicle maintenance,
- lower vehicle repair costs, and
- identification of unauthorized usage.

During its 2013–14 session, the General Assembly responded by requiring telematics and fleet management system planning and reporting by the Office of the State Chief Information Officer (CIO). Specifically, Session Law 2013-360, Section 7.16 (a)-(d) tasked the CIO to

- develop an implementation plan for a statewide motor fleet management system,
- begin quarterly status reporting in October 2013 to the Joint Legislative Oversight Committee on Information Technology and the Fiscal Research Division on an implementation plan for a fleet management information system, and
- report on the feasibility of a vehicle tracking system as recommended by the Program Evaluation Division by November 2013.

The law also required the Office of State Budget and Management to assist agencies with implementation and to identify funding from current and proposed projects and applications. However, the CIO did not meet the requirements of S.L. 2013-360, 7.16 (a)-(d) relative to fleet management or telematics. As a result, there has been no independent feasibility study of telematics.

The Program Evaluation Division also recommended collecting data on vehicle utilization to assist the State in seeking efficiencies for the DOA in-house system or gauging costs and benefits of large-scale outsourcing solutions. These efforts would enable the General Assembly to have

[23] Program Evaluation Division. (2012, March). *Motor Fleet Management Uses Best Practices, but Needs Telematics to Strengthen Accountability*. Report to the Joint Legislative Program Evaluation Oversight Committee. Raleigh, NC: General Assembly.

sufficient information to determine the cost-effectiveness of telematics.

The Motor Fleet Management division plans to have telematics services installed for its entire inventory by June 30, 2018. The total cost of equipment and installation is expected to be $1.9 million.[24] The purchase of telematics services includes the capacity to produce up to 30 reports that can be used to improve performance. Information provided by these reports includes

- after-hours usage,
- engine diagnostics and issues,
- accident reconstruction,
- total fuel used,
- automatic driver-to-vehicle pairing when logged in to the Drive App, and
- maintenance reminders.

The Motor Fleet Management division expects to see some immediate savings from the use of telematics. Savings realized upon installation can be categorized as passive savings, i.e., savings that require no additional effort from the division to achieve. An example of passive savings is behavioral adjustment in drivers such as reduction in excessive idling, speeding, harsh braking, acceleration, and cornering. The division reported that it anticipates these efficiency improvements will result in a savings of $0.02/mile from by June 30, 2019.

However, without proactive management of the information collected on driving behavior, associated self-modifications to behavior and their corresponding cost savings may dissipate. For example, a state employee who regularly exceeds the speed limit may reduce speed in a state-owned vehicle immediately after telematics is installed. However, if the employee reverts to speeding and encounters no punitive action then any passive savings and increased safety the State originally realized would likely cease.

Additional savings can be achieved by optimizing the inventory of state-owned vehicles. In Fiscal Year 2016–17, of the 6,187 vehicles managed by MFM that were in service for the entire year, 3,635 (59%) were driven less than the established minimum standard of 12,600 miles. The Motor Fleet Management division is statutorily required to review and determine whether to terminate assignment if a vehicle is driven less than 12,600 miles during the year.[25]

The State of Delaware's Fleet Services office also manages vehicles that are assigned to specific state agencies. Through expanded use of telematics data, Delaware realized a 22.6% reduction in its vehicle fleet inventory from 2008 to 2012. Also in that time period, Delaware Fleet

[24] The equipment is projected to last for approximately seven years and can be transferred to new vehicles when an equipped vehicle is taken out of service.

[25] As specified in N.C. Gen. Stat. § 143.341 (7a). However, as further specified the Division of Motor Fleet Management may not revoke the assignment of a vehicle to the Department of Transportation or an employee of that Department for failure to meet the minimum mileage requirement unless the Department of Transportation consents to the revocation.

Services achieved a 21.6% reduction in annual number of miles driven, as well as a corresponding 11.2% reduction in fuel use.

Modifications to the business processes used to manage state agency-assigned vehicles are required to more fully realize potential cost savings from telematics. Modifications to existing business processes will be required both to maintain initial savings from telematics implementation and to achieve other potential savings in the total costs of the State's vehicle inventory. To maintain the passive savings derived from adjustments to driving behavior, MFM will need to establish adequate monitoring and enforcement processes. To realize other potential savings from telematics, MFM may be required to conduct a more extensive analysis of its current business processes to determine how the newly available information can be most effectively utilized.

In summary, the Motor Fleet Management division is responsible for the cost-effective management of the state fleet of vehicles by lowering costs through the elimination of duplication and inefficiencies caused by the decentralized management of state-owned passenger vehicles. The division plans to complete its installation of telematics by June 30, 2018. Telematics will provide MFM with extensive information that can be used to improve performance. However, to realize all potential savings from telematics, modifications to current business processes may be required.

Recommendation 6. The General Assembly should direct the Department of Administration to establish or modify current business processes to ensure realization of potential reductions in the total cost of ownership for managed vehicles.

As described in Efficiency Opportunity 6, the Department of Administration is installing telematics on all of its managed vehicles. The information obtained from telematics can be utilized to reduce the total cost of vehicle ownership without adversely impacting performance.

To ensure the cost-effective management of state-owned vehicles, the General Assembly should direct DOA to modify the business processes used to manage its fleet of motor vehicles by utilizing the information collected from telematics. The revised business processes should be incorporated in a comprehensive policies and procedures manual for the Motor Fleet Management division. These revised business processes should ensure compliance with associated state agency requirements can be effectively monitored and enforced.

DOA should be directed to deliver the documented policies and procedures to the Joint Legislative Oversight Committee on General Government and the Fiscal Research Division by December 1, 2018.

Division: Mail Service Center

Division Description: As specified in statute, the Department of Administration (DOA) operates and maintains a Mail Service Center that shall be used by all State Agencies. DOA is responsible for ensuring that the MSC efficiently meets the needs of State agencies with no loss of federal funds, specifically by processing incoming mail and delivering it in a timely manner to the appropriate agency mail service center. Mail processing services include the receipt and sorting of incoming mail among each of the designated agency mail service centers, whereas delivery services include transporting incoming mail to each identified mail service center and providing courier services. In addition, the MSC provides presort mail services for state agencies as part of a contract with the United States Postal Service to obtain discounted postage charges.

The Mail Service Center is primarily funded from receipts from participating state agencies based on their proportionate share of the cost of mail service center operations. In Fiscal Year 2016–17, Mail Services was authorized 82 full-time equivalent positions and expended $3.8 million. The cost of processing incoming mail accounted for $1.4 million of these expenditures with the remaining $2.4 million attributed to the cost of mail delivery and courier services.

<u>Efficiency Opportunity 7:</u> Reduced cost of incoming mail processing

As shown in Exhibit 11, in Fiscal Year 2016–17, the Mail Service Center processed an estimated 4.7 million pieces of incoming mail. Incoming mail consists of letters, flats and parcels.[26] Each piece of mail was delivered to one of 558 designated mail service centers, which are located at 164 facilities in Wake County. The division also provided presort mail services for 22.8 million letters during the fiscal year.

Exhibit 11

In Fiscal Year 2016–17, the Mail Service Center Processed and Delivered an Estimated $4.7 Million Pieces of Mail

Mail Category	Estimated Volume (FY 2016–17)
Letters	**2,676,348**
Flats	**1,986,528**
Parcels	**67,284**
Total	**4,730,160**

Source: Program Evaluation Division based on data provided by DOA.

Using a document management system capable of scanning incoming mail to an electronic format can reduce costs and improve mail processing performance. Transitioning from both receiving and delivering paper mail to scanning incoming paper mail and then delivering it in an electronic format will reduce costs by eliminating the requirement to physically deliver the mail. Using a document management system capable of scanning incoming mail can also improve mail processing performance through faster delivery and elimination of future agency scanning requirements. In addition, state agencies may be able to improve their business operations through more efficient document distribution.

It is true that some mail pieces processed by the Mail Service Center cannot be scanned. Specifically, the MSC reported that 32,759 of 882,598 mail

[26] A "letter" refers to a mail category meeting minimum size standards and not exceeding the maximum dimensions of 11 ½ inches long, 6 1/8 inch high, and ¼ inch thick. A "flat" refers to large envelopes, newsletters, and magazines. To be considered a flat, the mail piece must have one dimension that is greater than 6 1/8 inches high or 11 ½ inches long or ¼ inch thick. A "parcel" is mail that does not meet the mail processing category of letter-size mail or flat-size mail. It is usually enclosed in a mailing container such as a carton.

pieces received in Fiscal Year 2016–17 were unscannable. These pieces included mail containing evidence to be used in judicial proceedings and mail containing biohazards.

To ensure compliance with applicable federal and state requirements, a decision to transition from receipt and delivery of paper mail to delivery in an electronic format should include consideration of the following:

- state agency requirements pertaining to needs for 'original' paper copies of documents;
- applicable confidentiality requirements, i.e. Health Insurance Portability and Accountability Act of 1996 (HIPAA), Internal Revenue Service (IRS), Criminal Justice Information Services (CJIS), etc.;
- mailroom monitoring and access control;
- shredding requirements;
- access to envelope scan and content; and
- security of transmission to the designated state entity.

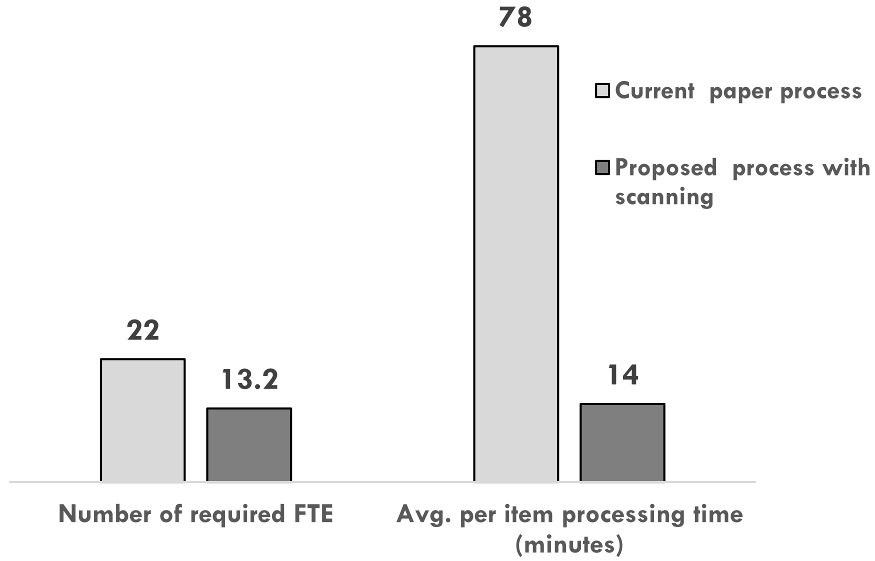
The North Carolina Department of Revenue (DOR) is planning a pilot study to determine if a document management system that includes scanning of incoming correspondence would improve service and is practical and affordable. In addition to its current practice of scanning readable tax documents, DOR is also exploring adding correspondence scanning capability. DOR has identified several inefficiencies associated with its current paper-based document management process including

- excessive time to process,
- difficultly in forwarding and sharing correspondence documents with other parts of the agency,
- slow response to constituents due to difficulty locating correspondence,
- difficultly in knowing which department currently has or is working on specific customer correspondence,
- difficultly of managing/purging correspondence records,
- lack of automated workflow for processing and approving response to correspondence, and
- the paper-intensive nature of the current manual process.

As shown in Exhibit 12, the Department of Revenue estimates that transitioning to a document management system that incorporates scanning of incoming mail would result in significant savings and also improve performance. Specifically, DOR has determined that the current process to manage hard-copy correspondence requires 22 FTE and takes, on average, one hour and 18 minutes per item. By comparison, DOR estimates that a document management system that incorporates scanning of incoming correspondence would require only 13.2 FTE and an average of 14 minutes per item.

Exhibit 12

Department of Revenue Estimates Transitioning to a Document Management System with Scanning Capability Would Lower Cost While Improving Performance



Source: Program Evaluation Division based on data provided by the Department of Revenue.

Because the incoming correspondence designated for scanning is considered Federal Tax Information and is therefore subject to IRS Publication 1075, DOR will be required to obtain additional licenses for software to ensure compliance. DOR believes these confidentiality requirements can be met through the purchase of licenses for FileNet software, which are estimated at $918 per named user with 20% of the license cost recurring if the product is retained.

DOR plans to conduct a three-month-long pilot study to compare the performance of the current paper-based document management system with a system that incorporates document scanning. The goal of the pilot is to determine if the implementation of a document management system incorporating document scanning is feasible, cost-effective, and would meet the needs of the business. DOR reports that if the pilot is successful, the department would like to then transfer the responsibility of scanning correspondence to the Department of Administration.

The Mail Service Center may be able to more cost-effectively provide mail scanning services for all state agencies. Using a single source to meet the State's document scanning requirements could serve to improve the overall efficiency of the State's document management processes. Efficiencies can be achieved by leveraging the volume of statewide scanning requirements to obtain lower prices.

The Department of Revenue reported that it should be feasible to utilize scanning services provided by the Mail Service Center to meet its correspondence scanning requirements. However, additional handling requirements would need to be met, such as ensuring:

- original correspondence was retained and then disposed of according to IRS Publication 1075,
- scanned images could be entered into DOR's system, and
- compliance was achieved with IRS Publication 1075 physical security and personnel background check requirements.

In summary, in Fiscal Year 2016–17 the Mail Service Center spent $3.8 million to process an estimated 4.7 million pieces of incoming mail and provide presort mail services for 22.8 million letters. The MSC may be able to reduce costs and improve mail processing performance by using a document management system capable of scanning incoming mail to an electronic format. The North Carolina Department of Revenue is planning a pilot study to determine if a document management system that includes scanning of incoming correspondence would improve service and is practical and affordable. The results of this pilot study can be used to determine the cost-effectiveness of increased scanning of incoming mail and whether the State's mail scanning services should be centralized with the Mail Service Center.

Recommendation 7. The General Assembly should direct the Department of Administration to conduct further study and develop a business case to compare incoming mail scanning to the current incoming mail process, and report to the General Assembly for next steps.

As described in Efficiency Opportunity 7, the Program Evaluation Division determined that using a document management system capable of scanning incoming mail to an electronic format can reduce costs and improve mail processing performance.

To ensure that the Mail Service Center cost-effectively manages mail services provided to state agencies, the General Assembly should direct DOA to perform a business case analysis that utilizes the results from the DOR document scanning pilot study to explore whether there is potential for savings through increased utilization of electronic mail scanning for incoming mail. The business case analysis should also include consideration of performing the service through a contract with a private entity and by Mail Service Center employees.

The Department of Administration should be required to provide the results of this analysis to the Joint Legislative Oversight Committee on General Government and the Fiscal Research Division by December 1, 2018.

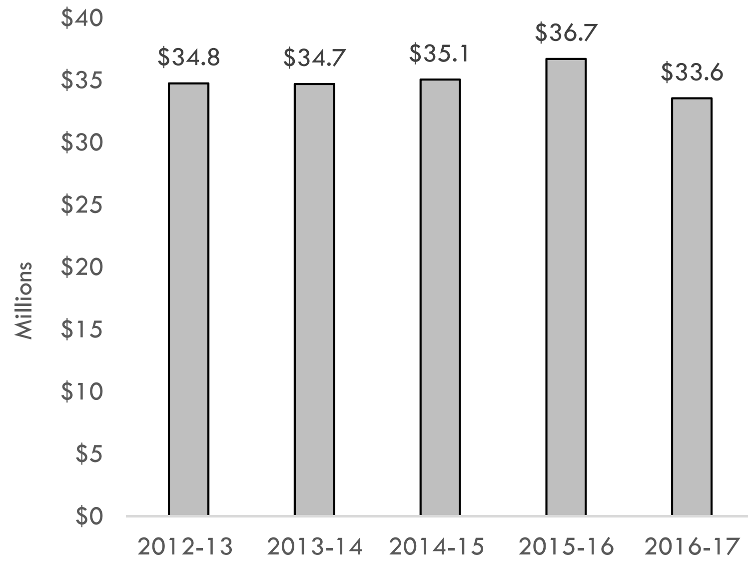
<u>Efficiency Opportunity 8:</u> Reducing cost of outgoing mail

In Fiscal Year 2016–17, state agencies expended $33.6 million for outgoing mail services. As shown in Exhibit 13, despite the increased availability of low-cost electronic forms of mail delivery, state agency mail service expenditures have not significantly changed since Fiscal Year 2012-13.[27]

[27] Based on Fiscal Year 2016-17 expenditures for the following North Carolina Accounting System expenditure account numbers: 532840000, 532840001, 532840002, and 532840003.

Exhibit 13

State Agency Mail Service Expenditures Have Not Significantly Changed During the Past Five Years



Source: Program Evaluation Division based on data provided by DOA.

A performance audit issued by the State of Washington of outgoing mail services at four state agencies resulted in identified annual cost savings of $3.1 million. In November 2011, the Washington State Auditor issued a performance audit that identified opportunities to reduce state mail volume and costs. This Auditor reviewed the four state agencies with largest mail volumes and performed a detailed analysis of 55 high-volume mailings these agencies sent that included more than 100,000 pieces per year.

The performance audit found that the agencies used paper mailing services more often than was required by law. For example, 20 percent of the high-volume mailings consisted of information the agencies were not required to deliver in any form. Further, the audit reported that in more than half of these high-volume mailings, the agencies were required only to "provide" the information, not necessarily to mail it.

As of July 2016, the Washington State Auditor reported that the four audited state agencies had saved $3.1 million annually by reducing their outgoing mail. For example, the Employment Security Department stopped mailing 42 continued claim messages to Unemployment Insurance claimants, resulting in an estimated annual savings of $1.8 million. Additionally, the Department of Social and Health Services conducted a review of 36 different mailings with annual volume of 100,000 pieces or more per year, with a combined volume of 16 million letters per year. This review identified six of the 36 mailing as not required. Of the other 30 mailings,

- 2 have been modified to reduce mailing cost,
- 4 require 'mailing' in the associated administrative rule and may require a change in the associated state or federal rule, and
- 24 require 'notification' in the rule and may require a federal waiver.

The 2011 Washington performance audit determined that agencies should not eliminate or reduce all mailings because in some instances mailing may be the best option for providing certain information. Agencies will need to balance any mail reduction efforts with several factors, including implementation costs, customer preferences and access to technology, and potential litigation risks.

The State of Washington's audit recommended that the Department of Enterprise Services develop general guidelines to help all state agencies evaluate opportunities to reduce outgoing mail volumes and costs. In addition, the audit recommended a review of relevant mailing requirements in state law or state regulations and that changes be pursued when requirements to "mail" hinder agencies' ability to communicate through other means.

In summary, in Fiscal Year 2016–17 state agencies expended $33.6 million on outgoing mail services. These annual expenditures have not significantly changed during the past five years despite the increased availability of low-cost electronic forms of mail delivery. The State of Washington conducted a performance audit of outgoing mail services that resulted in an annual reduction of $3.1 million in outgoing mail service expenditures.

Recommendation 8. The General Assembly should direct the Office of the State Auditor to conduct a performance audit to identify alternatives to reduce outgoing mail service costs.

As described in Efficiency Opportunity 8, the State can reduce the cost of outgoing mail services through increased utilization of electronic mail services.

To assist state agencies in reducing the cost of outgoing mail services, the General Assembly should direct the Office of the State Auditor to conduct a performance audit. The objective of the performance audit should be to identify alternatives to improve the cost-effectiveness of outgoing mail services provided by state agencies. The scope of the performance audit should include identification of:

- all appropriate performance targets for each reviewed agency;
- statutory requirements mandating the utilization of paper mailings that may be amended or eliminated;
- high-volume mailings deemed not attributable to the achievement of an agency mission or outcome that can be eliminated; and
- general guidelines to help all state agencies evaluate opportunities to reduce the cost of outgoing mail services.

<u>Efficiency Opportunity 9:</u> Increased use of presort contracts for outgoing mail postage charges

In Fiscal Year 2016–17, the Mail Service Center realized savings of $1.3 million through utilization of a contract with the United States Postal Service. In Fiscal Year 2016–17, the Mail Service Center contracted with the United States Postal Service for discounted postage rates. As a condition of receiving the discounted rate, the MSC agreed to provide presort mail services. In 2016, the MSC transferred fulfillment of the presorting requirements to a private vendor in order to realize the associated discount. In Fiscal Year 2016–17, agencies were assessed $39,000 for these services. Utilization of this contract enabled the MSC to achieve a $1.3 million cost avoidance, which represented a 33% discount in assessed charges.

However, in Fiscal Year 2016–17, only $2.8 million of the $14.2 million expended on postage and postal meter charges utilized the presort contract negotiated by the Mail Service Center Division. The current presort contract with the United States Postal Service allows every outbound letter to qualify for the associated discount and provides access for outgoing mail processing for all state agencies. Consequently, agency-administered outgoing mail processing may not be fully realizing potential savings from the mail presorting contracts established by the Mail Service Center.

The Mail Service Center reported that it does not monitor whether agencies have established a similar presort contract with the United States Postal Service. Consequently, determination of potential savings associated with full utilization of the existing presort contract as administered by the Mail Service Center was unavailable.

In summary, in Fiscal Year 2016–17, the Mail Service Center contracted with the United States Postal Service for discounted postage rates, which represented a 33% discount in assessed charges. As a condition of receiving the discounted rate, the MSC agreed to provide presort mail services. However, in Fiscal Year 2016–17, only $2.8 million of the $14.2 million expended on postage and postal meter charges utilized the presort contract negotiated by the Mail Service Center.

Recommendation 9. The General Assembly should direct the Department of Administration to conduct further analysis to identify cost-effective alternatives to increase the utilization of presort contracts for outgoing mail services.

As described in Efficiency Opportunity 9 increased utilization of presort mail contracts between the Mail Service Center and the United States Postal Service can result in significant cost avoidance. The scope of the analysis should include consideration of alternatives to more fully utilize the presort mail contracts between the Mail Service Center and the United States Postal Service.

Division: State Parking

Division Description: As specified in statute, the State Parking division of the Department of Administration is delegated authority to adopt reasonable rules and regulations with respect to the parking of automobiles on all public grounds.[28] The mission of the State Parking division is "*To provide effective and efficient parking and transportation options that enable employees, departments, and visitors to have access to the downtown state government complex*." The critical functions State Parking provides to meet its mission are:

[28] N.C. Gen. Stat. § 143-340 (18)

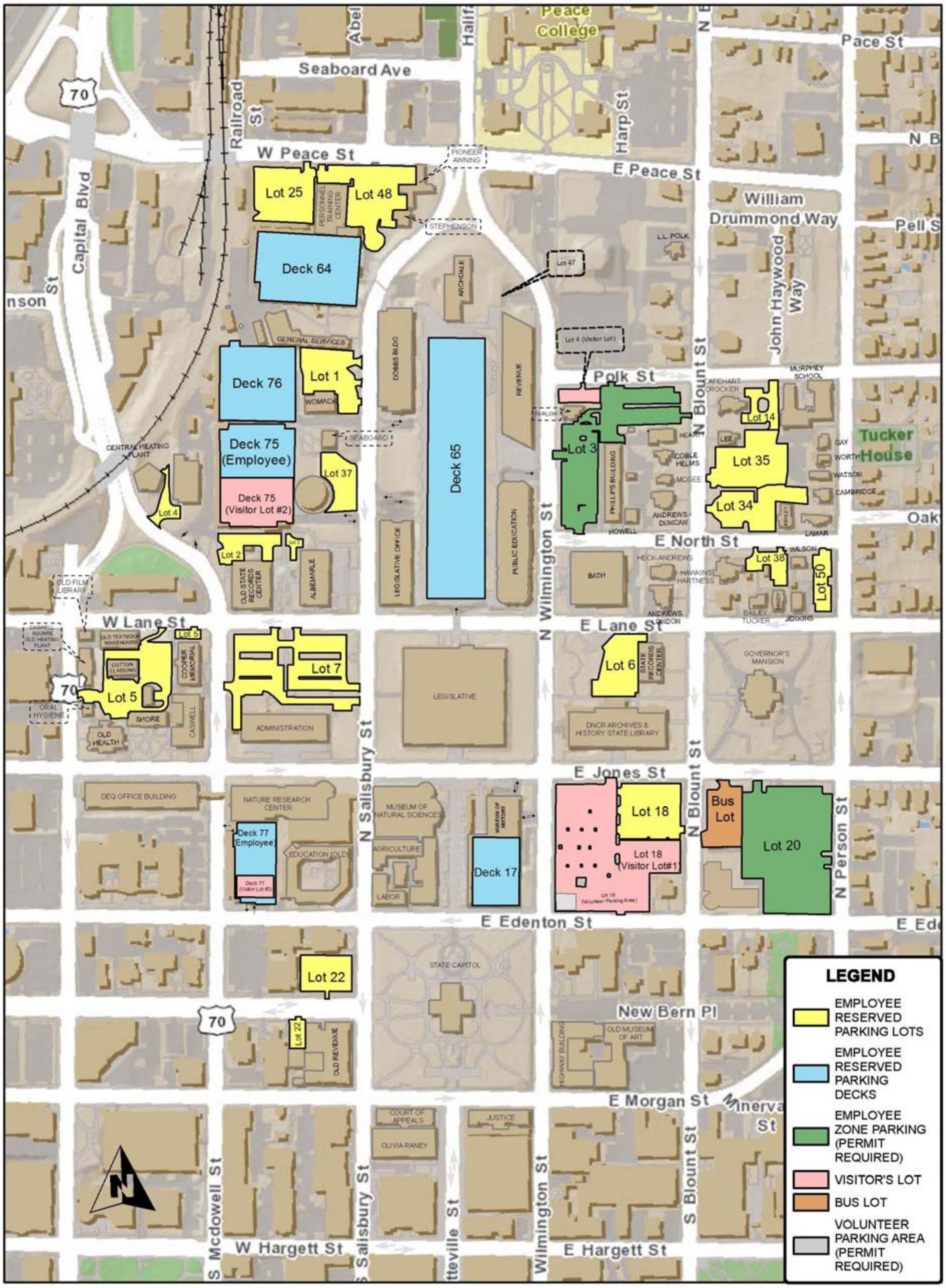
- managing the employee parking inventory and allocation of parking spaces to 36 state entities for employee and departmental uses,
- providing parking for visitors,
- encouraging the use of transportation alternatives by employees,
- ensure parking facilities are well-maintained and safe, and
- funding daily parking operations and routine maintenance costs through receipts.

The State Parking division is primarily funded by receipts from state entities with assigned parking spaces and revenues generated from charges for utilization of visitor parking spaces. In Fiscal Year 2016–17, the division generated $2.3 million in revenues with $1.2 million derived from the provision of employee and departmental usage and $1.1 million from charges for visitor parking services. To generate these revenues, the State Parking Program expended $2 million in Fiscal Year 2016–17.

As shown in Exhibits 14 and 15, as of June 30, 2017, the State Parking division operated 28 facilities with a total of 8,434 parking spaces. There were 24 lots designated for 31 state entities and their employees. These 24 lots contained 7,579 spaces, of which 6,480 were reserved for designated employees or purposes and 1,099 were unreserved.[29] In addition, State Parking operates and maintains four parking facilities that are designated for visitor parking. These four facilities, which contain a total of 855 spaces, operate for 10 hours per day during state business days and charge $2 per hour or $20 for the day.

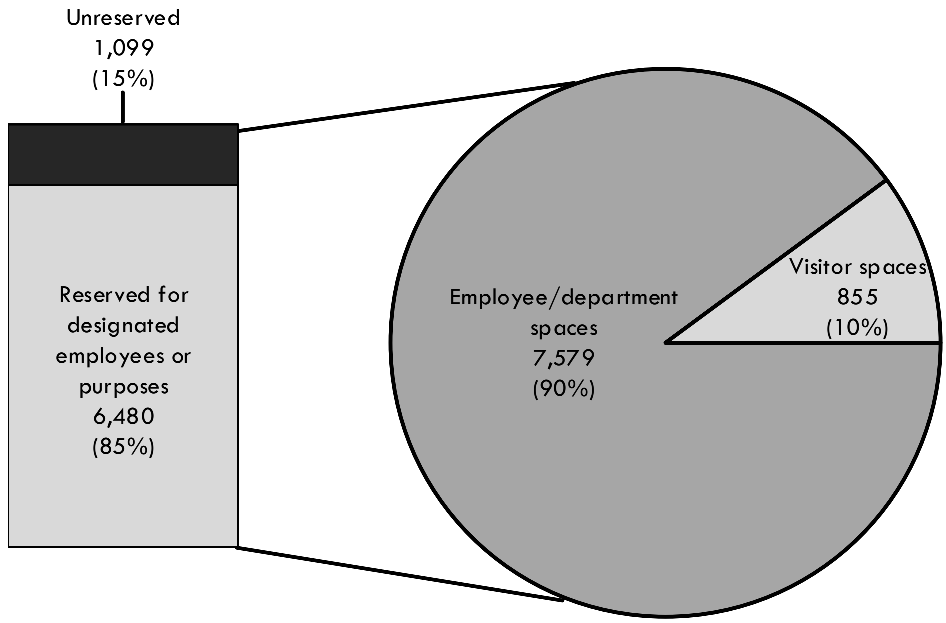
[29] As unreserved parking designation allows an individual to select an available space from a designated group of spaces in a specified parking facility.

Exhibit 14: State Parking Operates 28 Facilities in the Downtown Government Complex



Source: Program Evaluation Division based on data provided by DOA.

Exhibit 15: Eighty-Five Percent of Employee/Department Spaces Managed by State Parking Division are Reserved



Source: Program Evaluation Division based on data provided by DOA.

<u>Efficiency Opportunity 10:</u> More cost-effective utilization of available parking spaces

In Fiscal Year 2016–17, visitor parking spaces generated only 25% of potential revenues. The State Parking division garnered an average of $4.99 per space for visitor parking spaces in Fiscal Year 2016–17, ranging from an average of $3.82 per month in November 2016 to $6.91 in March 2016. Revenues from visitor parking for the year totaled $1.1 million, which represents only 25% of the potential revenue of $4.4 million that could have been generated given current staffing and hours of operation. DOA reported that during peak traffic months, paid occupancy averages increase to between 28% and 33%. In addition, during the peak of the legislative session, some visitor lots are filled to capacity.

Parking spaces designated for state agencies and their employees may also have been underutilized. Of the State Parking division's 6,480 reserved employee/department spaces, an average of 8% per month were unassigned in Fiscal Year 2016–17, and an average of 20% per month of the division's 1,099 unreserved employee/department spaces were unoccupied.

Overall, the State Parking Division estimates that, on average, 20 to 30% of available spaces are unoccupied.[30] The division reported that this vacancy rate is well above the industry standard that requires at least 85% of spaces be occupied. The primary reason for this underutilization is the prevalence of reserved spaces. Utilization of reserved spaces does not

[30] Based on occupancy counts by the State Parking division of state-owned parking facilities.

allow for ‘overbooking’ of spaces to account for the expected number of unused spaces.

There are several available alternatives to more cost-effectively utilize state parking facilities. Actions that the State Parking division could pursue to increase revenues from state-owned parking facilities include converting spaces from reserved to unreserved and reducing the number of available visitor spaces. Converting parking spaces from reserved to unreserved would allow for the overselling of these newly unreserved spaces while still ensuring state employees would be able to readily access a space.

These conversions would serve to free up spaces that could then be made available for lease either to private individuals or to a public or private entity, which could also be accomplished by reducing the number of available visitor parking spaces to more closely match demand. The division estimates that depending on location, lease rates for each space would vary from $50 to $85 per month.

Other alternatives to increase the amount of revenue generated from state-owned parking facilities include installing pay stations at lots currently offering free night and weekend parking services and expanding the hours of operation for visitor lots.

However, transitioning reserved spaces to unreserved parking spaces may adversely affect state employees. For example, because an unreserved parking space assignment does not guarantee a specific space, employees may be forced to expend more time and effort to find a parking space. Therefore, any conversion of parking spaces from reserved to unreserved should ensure consideration of potential adverse impacts to state employees.

In addition, each of these alternatives would require additional resources to fully implement. For example, the State Parking division estimates that the cost to realize potential revenues from leasing available spaces to private individuals, businesses, or local governments would be $4,000. These costs are associated with establishment of additional parking credentials, signage upgrades, and communication outreach.

In summary, the State Parking division manages 28 state-owned parking facilities. In Fiscal Year 2016–17, State Parking operations generated $2.3 million in revenues with $1.2 million derived from providing employee and departmental usage and $1.1 million from charges for visitor parking services. However, only 25% of potential revenues from visitor parking spaces were realized and an estimated 20% to 30% of state employee parking spaces go unused each day. There are several alternatives to increase the amount of revenue generated from state-owned parking facilities but each option would entail some additional costs and could adversely impact state employees.

Recommendation 10. The General Assembly should direct the Department of Administration to conduct analysis on available opportunities to increase revenue receipts derived from state-owned parking facilities.

As described in Efficiency Opportunity 10, state-owned parking facilities can be more effectively utilized to generate additional revenues without adversely impacting state employees or visitors.

To ensure state-owned parking facilities are being cost-effectively utilized, the General Assembly should direct DOA to perform a business case analysis, the object of which should be to explore potential alternatives to increase the amount of revenue generated from the use of state-owned parking facilities. The scope of the analysis should include consideration of increased utilization of unreserved spaces, leasing of underutilized employee spaces and visitor spaces to public and private entities, and installation of pay stations at select lots that do not currently charge for overnight or weekend parking services.

The Department of Administration should be required to provide the results of this analysis to the Joint Legislative Oversight Committee on General Government and the Fiscal Research Division by December 1, 2018.

Overarching Recommendations

Recommendation 11. To ensure that Department of Administration (DOA) performance can be effectively monitored and managed, the General Assembly should amend statute to include legislative performance measures and require DOA to provide an annual report that includes prior year results for each identified measure as well as the performance target for the upcoming fiscal year.

As discussed in several efficiency opportunity sections, baseline performance information is needed to properly consider alternatives to reduce program cost and improve performance. While the Department of Administration (DOA) has developed performance measures for many of its activities and services, the Program Evaluation Division determined that these measures did not provide adequate information on the overall level of efficiency for all DOA divisions with identified efficiency opportunities.

To help ensure it can evaluate the overall performance of the activities and services administered by the Department of Administration and can evaluate alternatives to improve operational efficiencies, the General Assembly should amend statute to include the following efficiency measures. For each identified measure, the methodology to calculate the measure should include the identified minimum requirements and ensure the associated calculation produces valid and reliable results and can be compared with prior performance results.

<u>Divisions:</u> **Facility Management and State Property Office**

Legislative Performance Measure: Annual Facility Management Cost/Full-time Equivalent Position (FTE)

Minimum requirements: The data to identify the total cost of facilities should be derived from expenditures as identified under each of the following North Carolina Accounting System (NCAS) expenditure accounts:

- 532184-Janitorial Services
- 532188-Lawns and Grounds Services
- 532310-Repairs-Buildings
- 532320-Repairs-Other Structures (includes Street Maintenance)
- 532410-Maintenance Agreement-Buildings
- 532420-Maintenance Agreement-Other Structures
- 532187-Pest Control Services
- 532185-Waste Removal/Recycling Services
- 532186-Security Services
- 5322X-Utility/Energy Services
- 532512-Rent/Lease – Buildings/Office
- 532512000-Rent/Lease – Building/Office
- 532513-Rent/Lease – Other Facilities
- 532513000-Rent/Lease – Other Facilities

Number of FTE should be based on total authorized FTE in the Office of State Human Resources' Payroll System (BEACON).

Division: Motor Fleet Management

Legislative Performance Measure: Total Cost of Ownership (TCO)

Minimum requirements: As stipulated in G.S. 143-341, Section 31.3(d), total cost of ownership should include:

- vehicle replacement cost,
- maintenance cost,
- insurance,
- use of telematics devices, and
- DOA's administration cost.

Division: Purchase and Contract

Legislative Performance Measure: State term contract compliance rate

Minimum requirements: The state term contract compliance rate should identify the ratio of the value of goods and services purchased under a state term contract to the value of goods and services eligible to be purchased under a state term contract.

Legislative Performance Measure: State term contract savings

Minimum requirements: State term contract savings should reflect the monetary impact of state term contracts on purchases made by state agencies. The annual savings derived from utilization of state term contracts should be calculated by determining the difference between the ratio of the annual weighted dollar average of the unit cost of all state term contracts in effect during the fiscal year to the associated weighted dollar average of the unit cost of retail purchases subject to a state term contract.

Legislative Performance Measure: Percentage of annual expenditures for contracted services procured through a competitive bidding process

Minimum requirements: The annual value of contracted services eligible for competitive procurement should include the value of the expenditures associated with contracts with an award value exceeding $25,000 that were obligated during the fiscal year. The contract award value should be based on the estimated realized revenue to the service provider during the contract period including extension periods authorized in the original contract. The value of the obligated expenditures should also include the value of all associated modifications and extensions. In addition, extensions may only be considered to be competitively procured if the obligated value of the extension is at least 10% less than prorated value of associated services under the original contract.

Division: Mail Service Center

Legislative Performance Measure: Annual cost of incoming mail processing

Minimum requirements: Incoming mail processing costs should be limited to the cost of Mail Service Center operations as reported in NCAS expenditure account 1307-7218.

Legislative Performance Measure: Annual cost of outgoing mail processing

Minimum requirements: Outgoing mail processing costs should be the total cost of expenditures by state agencies for outgoing mail processing as reported in the following NCAS expenditure accounts:

- 532840: Postage, Freight and Delivery
- 532840000: Postage, Freight and Delivery
- 532840001: Postage, Freight and Delivery, Mailing Services
- 532840002: Postage, Freight and Delivery, Freight and Delivery
- 532840003: Postage, Freight and Delivery, Postal Meter

Division: State Parking

Legislative Performance Measure: Annual receipts net operating expenses

Minimum requirements: Annual receipts and operating expenditures should be derived from the following NCAS expenditure accounts:

- 434190: Other Sales & Services
- 434190004: Other-Equipment Usage fee
- 434320: Sale of Surplus Property
- 43421003: Surplus—Nonop-equipment
- 434390: Other Sales of goods
- 434430: Rental Parking Lots

- 434200006: Parking Stickers
- 435900021: Application fee
- 437127: Procurement Card Rebates
- 437990: Other Misc. Revenue
- 434430: Rental Parking Lots (visitor)

For each of these legislative efficiency measures, the General Assembly should direct the Office of the State Auditor to conduct annual assessments of the data utilized by the Department of Administration and the General Assembly to ensure and monitor the effective management of DOA-administered facility asset management programs. At a minimum, these assessments should include a determination of the validity and reliability of each associated data element as well as the impact of any changes in the methodology to identify the data and calculate the associated efficiency measure on the results identified in previous years. The results of these annual assessments should be provided to the Joint Legislative Oversight Committee on General Government, Program Evaluation Division, and the Fiscal Research Division by March 1.

In addition, the General Assembly should amend state law to require the Department of Administration to provide the Joint Legislative Oversight Committee on General Government and the Fiscal Research Division with an annual report on each authorized legislative performance measure to include the results and associated performance target for each previous fiscal year as well as the performance target for following fiscal year. The annual performance report should be provided by December 1.

Recommendation 12. To ensure effective consideration of efficiency opportunities involving potential outsourcing of services or transfer of the responsibility for asset management to the private sector, the General Assembly should establish requirements for an associated business case analysis.

As discussed throughout this study, the State may be able to realize cost savings by increasing the level of contracted services utilized to perform certain functions delivered by divisions within the Department of Administration. Each of these identified divisions has opportunities to improve the efficiency of its operations without adversely impacting performance.

Though transferring responsibility for the operation of a service or asset can serve to reduce cost and improve performance, it also increases the risk of inadequate performance. Consequently, the decision to transfer responsibility for these operations should be based on consideration of all relevant factors. For each recommendation that includes the development of a business case analysis to explore ways to improve services and specifies that the scope include consideration of increased use of contracted services, the business case analysis should, at a minimum, include:

- unit and total cost of performing the service(s) for the most recently completed fiscal year;
- description of metrics to evaluate performance;

- current and expected performance for each identified metric;
- detailed description of current process and associated state and federal statutory requirements to perform service(s);
- changes needed to current process and associated state and federal statutory requirements to achieve best value from each service delivery alternative;
- assurance that impacted state employees are given priority in the utilization of any additional contracted services;
- identification of performance-based financial incentives that can be utilized to the fullest extent possible to include contributions from affected state agencies and their employees;
- contract formation and management resource requirements to ensure best value is obtained;
- availability of private sector service providers;
- justification for waiver of competitive bidding requirements, if applicable;
- justification for use of multiple providers to perform service, if applicable;
- information security requirements, as applicable;
- identification of roles, organizational placement, responsibilities, and qualifications of key project team members, to include demonstrated competency incorporating government-vendor partnerships into the procurement process;
- funding requirements and associated funding sources for the proposed contract period; and
- a service delivery transition process, both incoming and outgoing.

Recommendation 13. To help ensure the proper conduct and timely delivery of recommendation(s) pertaining to each authorized efficiency opportunity, the General Assembly should direct the Department of Administration to establish a dedicated Project Management Office.

As discussed throughout the study, the State may be able to realize cost savings by improving the business processes used to manage the assets and services under the jurisdiction of the Department of Administration.

To ensure the proper conduct and timely delivery of recommendation(s) pertaining to each authorized efficiency opportunity, the General Assembly should direct DOA to establish a dedicated Project Management Office. The Project Management Office should not be housed within an existing division of DOA and should have direct reporting authority to the department Secretary. The Project Management Office should be responsible for ensuring the recommendation(s) pertaining to each authorized efficiency opportunity are properly conducted and delivered in a timely manner to the Joint Legislative Oversight Committee on General Government and, upon request, to other committees.

In addition, the Project Management Office should be responsible for providing administrative support services. These support services should include procurement of appropriate technical expertise from available sources including the university and community college systems, state agencies, and private entities with specific expertise in the affected activities and services. To meet these responsibilities, the General Assembly should provide a one-time appropriation of $500,000 to DOA to fund the operations of the Project Management Office.

The General Assembly should direct that by December 1, 2018, the designated project office provide the associated analysis and conclusions for each of the recommendation(s) pertaining to authorized efficiency opportunities to the Joint Legislative Oversight Committee on General Government and, upon request, to other committees.

Agency Responses

A draft of this report was submitted to the Department of Administration to review. Its response is provided following the report.

Program Evaluation Division Contact and Acknowledgments

For more information on this report, please contact Chuck Hefren at Chuck.Hefren@ncleg.net.

Staff members who made key contributions to this report include Adora Thayer and Jim Horne, CPA. John W. Turcotte is the director of the Program Evaluation Division.

State of North Carolina
DEPARTMENT OF ADMINISTRATION

Roy Cooper
Governor

Machelle Sanders
Secretary

April 4, 2018

John Turcotte
Program Evaluation Division, Director
North Carolina General Assembly
212 Legislative Office Building
300 N. Salisbury Street
Raleigh, NC 27603

Re: Formal Response to Draft Report – *Efficiency Evaluation of the NC Department of Administration*

Dear Mr. Turcotte,

The NC Department of Administration appreciates the opportunity to review and respond to the above-mentioned study that began in the fall of 2017. I commend your staff for their time devoted to this major study to identify opportunities for efficiency in state government.

As the business manager for state government, the Department is fully engaged in providing core services to each state agency as directed by general statute. In order to provide superior service to the state, each Division has aligned its activities with the following strategic imperatives:

1- Explore new and improved ways to deliver effective and efficient services to create value for taxpayers;
2- Provide superior customer service; and
3- Create a culture of trust through enhanced employee engagement, openness and inclusiveness

When the legislature adjourned in August 2017, the Department engaged in five Program Evaluation studies – the largest of which is the Efficiency Evaluation. DOA Deputy Secretaries, Division Directors, and key staff have invested over **3,000 hours** during the past 6 months to engage in interviews with Program Evaluation staff and Pro Comm consultants, provide baseline data, and to explain our decision-making processes and relevant statutory authority.
After further review of the efficiency measures and recommendations, please consider the Department's perspective regarding conclusions drawn in the Efficiency Evaluation Report:

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116 WEST JONES STREET
RALEIGH, NORTH CAROLINA 27603

Background:

The Department of Administration oversees the following: (1) Government operations , i.e. state building construction, purchasing and contracting for goods and services, managing state vehicles, acquiring and disposing of real property, facility maintenance (2) Auxiliary services, i.e. courier mail delivery and state and federal surplus property sales, and (3) Advocacy programs, providing assistance and services through state and federal grants to diverse segments of the state's population that have been traditionally underserved.

Recommendation 1: The NCGA should direct DOA to establish and enforce space utilization criteria for each state-owned and leased office facility.

The suggested directive in Recommendation 1 is a replication of existing mandates, in *Session Law 2016-119.* The Department strongly believes that in order to continue successful implementation of space utilization standards, the State Property Office database must first be funded, giving the state capability to capture the necessary data. Though $552,000 was earmarked for a study in 2015, funding has yet to be identified to fully execute *SL 2016-119.* We are actively engaged in training all state agencies to ensure compliance. It is important to note that the State Property Office is an agent of the state and therefore is reliant on agencies to convey their needs. Acting as an agent of the state, *SL 2016-119* gives DOA legislative authority to collect from each state agency a five-year property management plan, and then to develop a statewide property management plan as referenced by the following session law (*2016-119*) requiring DOA to:

> (1) develop a comprehensive State facilities plan (due December 1, 2018);
> (2) establish a performance management system to measure the State's achievement of the priorities required in (a)(1) (due December 1, 2018);
> (3) develop and distribute procedures to State agencies to be used to measure the utilization of state-owned and leased property (completed December 2016);
> (4) develop and distribute to State agencies space planning standards (completed December 2016).

In lieu of yet another study, the Department believes the state's greatest return on investment comes from investing funds in the completing the mandates of *Session Law 2016-119* rather than creating a duplicative study that could thwart efficiency gains.

Recommendation 2: NCGA should direct DOA to evaluate alternatives to reduce facility management costs, and to generate additional revenue, through more effective use of state owned and leased facilities.

The Department believes the most prudent way to evaluate the state's facility cost and make the most effective use of state property is to complete a Capital Area Master Plan, as requested in the 2017-2019 biennium budget. The Department is fully engaged in implementation and compliance with *Session Law 2016-119*, as we are evaluating state property for efficiencies and effectiveness.

Recommendation 3: NCGA should direct DOA to perform a business case analysis of Facility Management services performed on state-owned property under management of DOA.

The Department provides the following services through Facilities Management in an effort to provide every state employee a safe and healthful work environment in a cost effective and energy efficient way: (1) Preventive maintenance, (2) Routine maintenance, and (3) Emergency maintenance as needed for all facilities allocated to DOA, encompassing a total of 169 state owned building located primarily in the capitol city. In 2016, the Department initiated a study of the state's facility management operations. In 2017, the Department received from JLL, the *Facility Maintenance Management Assessment* report. Having received the comprehensive JLL Report, which examined the costs of all services currently provided by DOA, the Department is currently considering all feasible options to determine the best path forward.

Recommendation 4: The General Assembly should direct the Department of Administration to monitor enforcement of statutory compliance with state term contract utilization requirements by state agencies.

The Department agrees with this recommendation and is committed to implementing it to the extent possible with current staffing and technology. The efficiency analysis correctly points out that the most effective opportunity for compliance is in *prevention*. The Division's current technology is aged and not optimal to identify non-compliance due to its limited functional capabilities. At present, the Division is monitoring agency compliance with statewide term contracts on a multi-year cycle. Staff augmentation and upgraded technology will aid the state in increasing compliance with statewide term contract usage.

The Department supports amending legislation to require the use of the E-Procurement tool by entities subject to G.S. 143, Section 3, and to establish contingencies for the use of other purchasing methods when a statewide term contract exists for the commodities. The success of this recommendation hinges upon allocation of additional resources necessary for proper monitoring and management of state term contract compliance, along with enforcement authority.

The Division of Purchase and Contract currently identifies overall average discounts on each state term contract. The division supports determining the expected discount on the applicable retail unit cost for each state term contract good or service when the negotiated contract items are distinct. Per item detail is not reasonable when the items are categorically the same, such as furniture discounted by the manufacturer at the category level for any item purchased. Per item detail would not be reasonable for a retailer that offers a blanket percentage discount on thousands of potential units with prices that fluctuate with the market.

Recommendation 5a: The General Assembly should direct the Department of Administration to procure and implement a contract management system for state agency-administered contracted services.

The Division of Purchase and Contract agrees with this recommendation. P&C is collaborating with the Department of Information Technology (DIT) to gather requirements that will be used in procuring a more robust, end-to-end system capable of managing the entire procurement process—from creating the solicitation, to accepting electronic responses, to evaluating and awarding, to contract management. DIT manages the process for information technology procurement. The Department further agrees that requiring agencies to actively manage their services procurement process, based on sound scope development and delivery criteria to support business needs, is paramount to the success of any services procurement. Developing basic contract management practices through training and mentorship should have greater prominence than the employment of technology to support ineffective practices. We believe reporting is important and agencies should be required to report contract spend annually. The age, source, and scope of a contract will likely dictate the quality of the data reported.

Recommendation 5b: The General Assembly should direct the Division of Purchase and Contract to require state agencies to obtain a 10% reduction from the annual value of the original contract as a condition of awarding an amendment to a contract that extends the period of time in which a service provider is authorized to expend funds.

The Department believes a contract management system would facilitate approval of progress payments commensurate with work progress and aid in triggering timeline notifications to allow for a timely rebid when necessary. In instances where a contractor is required to deliver a product within a designated timeframe as a condition of payment, the Division of Purchase and Contract supports seeking a reasonable reduction from the value of the contract extension as a condition of not requiring a competitive rebid. In these cases, offering an opportunity for a price reduction in lieu of rebidding is a viable, cost-efficient option for both the agency and the vendor. A contract management system would be advantageous in situations like this. Many of the extensions to date are the result of service continuations that are necessary for the contracting agency to avoid service disruptions. An example would be the DHHS choosing to extend a vendor while awaiting the implementation of an impending program change rather than immediately resoliciting, potentially onboarding a different vendor for a short period, and resoliciting again to support planned program changes. In circumstances like this where an agency provides program services to its customers through a vendor, and the program is in a change cycle, the net impact of change would be both costly (for the agency and vendor) and disruptive. The 10% reduction could be punitive and unfair for the vendor, and possibly result in service disruption for the agency.

Recommendation 6: The General Assembly should direct the Department of Administration to establish or modify current business processes to ensure realization of potential reductions in the total cost of ownership for managed vehicles.

The Department is currently implementing telematics, as directed by the NC General Assembly, on all vehicles managed by the Division of Motor Fleet Management (MFM). MFM is on track to have telematics installed on 90% of Motor Fleet managed vehicles by June 30, 2018 with full implementation by December 31, 2018. Agencies will be able to utilize data to reduce the total cost of vehicle ownership and further right size their fleets. Motor Fleet Management has updated the rate structure to capture the total cost of ownership as recommended in the 2015 NC Gear study.

Recommendation 7: The General Assembly should direct the Department of Administration to conduct further study and develop a business case to compare incoming mail scanning to the current incoming mail process, and report to the General Assembly for next steps.

A reduction in cost of incoming mail processing is premised on eliminating the requirement to physically deliver the mail. Incoming mail consists of letters, flats and parcels to be delivered to 549 divisions at 166 unique locations. During Fiscal Year 2016-2017, approximately 33,000 incoming mail pieces received could not be scanned. Incoming mail not capable of being scanned still requires physical delivery to agencies. Thus, the costs of implementing incoming mail scanning capabilities would be in addition to operational expenses required to deliver incoming mail that cannot be scanned.

The cost of rolling out a centralized incoming mail scanning service would require that all State agencies currently receiving mail from the MSC have compatible software for receiving and viewing scanned mail. This would necessitate software licensing agreements with associated annual fees for all agency users at a cost that could possibly negate or exceed savings, if any, realized from scanning mail.

The Program Evaluation Division (PED) referenced a pilot study that the North Carolina Department of Revenue (DOR) is planning to conduct over a three-month period for exploring correspondence scanning capability. Factors that must be taken in consideration when opting to scan incoming mail include: requirements to retain "original" paper copies; confidentiality related to Health Insurance Portability and Accountability Act of 1996 (HIPAA) and Protected Personal Information (PPI), and other sensitive matters, shredding requirements and security concerns, including mailroom monitoring, access controls, and security of transmission. DOA believes that before committing to the costly resources required to undertake an additional study of scanning incoming mail, it would be prudent to first review the conclusions of the DOR pilot to determine if desired outcomes of efficiencies and savings were achieved.

Recommendation 8: The General Assembly should direct the Office of the State Auditor to conduct a performance audit to identify alternatives to reduce outgoing mail service cost.

The Department of Administration agrees that a State Auditor performance audit to identify cost-effective alternatives for outgoing mail services could help reduce the state's cost for outgoing mail.

Recommendation 9: The General Assembly should direct the Department of Administration to conduct further analysis to identify cost-effective alternatives to increase the utilization of presort contract for outgoing mail services.

The Department of Administration agrees and remains committed to educating agencies on cost savings opportunities tied to presort contracts for outgoing mail. The Department is committed to identifying cost effective alternatives to expand cost savings for outgoing mail to maximize the benefit to the State of the presort discount contracts.

It should be noted that successes tied to Recommendation 8 will impact outgoing mail volume and could adversely affect the negotiated discount with the United States Postal Service (USPS) as the USPS discount is tied to outgoing mail volume.

Recommendation 10: Recommend NCGA direct DOA to conduct an analysis of available opportunities to increase revenue receipts derived from state-owned parking facilities

The Department continues to look for ways to increase utilization while maximizing revenue options for the state.

Recommendation 11: To ensure that Department of Administration (DOA) performance can be effectively monitored and managed, the General Assembly should amend statutes to include legislative performance measures and require DOA to provide an annual report that includes prior year results for each identified measure as well as the performance target for the upcoming fiscal year.

In partnership with the Office of State Budget and Managements, the Department has performance measurements in place.

Recommendation 12: To ensure effective consideration of efficiency opportunities involving potential outsourcing of services or transfer of the responsibility for asset management to the private sector, the General Assembly should establish requirements for a business case analysis

The Department believes we have the resources to conduct business case analyses as appropriate.

Recommendation 13: To help ensure the proper conduct and timely delivery of recommendation(s) pertaining to each authorized efficiency opportunity, the General Assembly should direct the Department of Administration to establish a dedicated Project Management Office.

The Department believes these resources could be best spent on producing results and outcomes, such as the property management database and Capital Area Master Plan.

In closing, I would like to thank the Department of Administration staff for their tireless efforts in supporting the Efficiency Evaluation while remaining committed to providing excellent customer service to the state.

Sincerely,

Machelle Sanders

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Office of State Auditor Response to the Program Evaluation Division Report to Improve the Efficiency of The State's Administrative Services

Session Law 2017-57 required the Program Evaluation Division (PED) to conduct measurability assessments, as provided in Chapter 143E of the General Statutes, and efficiency evaluations of programs and administrative activities of the Department of Administration to improve accountability reporting and to recommend potential cost savings. Session Law 2017-57 also requires the State Auditor to review the draft findings and recommendations and provide a written response to be included in the PED's report.

The following is a "best effort" to respond as the Office of the State Auditor (OSA) did not have ample time to delve into the assumptions made and data used to provide a more in-depth response.

Additionally, the OSA would like to emphasize that the effectiveness of cost savings or efficiency studies in North Carolina state government are improved when actual data that exists in North Carolina agencies is used rather than industry averages or data from other states, unless those other states are similar to North Carolina. To date, accurate and reliable data for the type of decisions that this report looks to make is practically nonexistent.

The OSA neither endorses nor opposes any of the opportunities or recommendations identified in the PED's report.

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Efficiency Opportunity 1: Cost-effective achievement of state occupancy standards

Recommendation 1: The General Assembly should direct the Department of Administration to establish and enforce space utilization criteria for each state-owned and leased office facility.

State Auditor's Response:

The OSA agrees with the PED's above recommendation that this topic has the potential to produce significant savings for the state given the following:

- The number of state-owned and leased facilities and therefore the net square footage (NSF) of office space utilized by 89,000 state employees is significant
- The age of some state-owned buildings lends credence to the fact that the use at the time they were built has changed significantly over decades given changes in technology and needs/uses of state agencies

- The footprint of older state-owned buildings may not be configured to best utilize the square footage the state owns
- Buildings that were leased on an annual basis may not be the best utilization of square footage per full-time equivalent (FTE) currently
- **Most significantly**, the information necessary to evaluate the use of NSF per FTE has never been obtained or maintained by the Department of Administration. Therefore, it is doubtful that any type of assessment has ever been performed over the last two decades to ensure that North Carolina State Government is most efficiently utilizing space that is owned or leased.

Items of Concern:

The data needed to conduct the efficiency study outlined in PED's report does not exist or the data that does exist is inaccurate and unreliable. For Instance:

- There is no evidence that the Department of Administration maintains a complete and accurate inventory of all property owned or leased by the state
- Square footage utilization data, that the Department of Administration does have, is self-reported and has never been audited or confirmed
- PED attempted to use tax assessment values from Wake County Tax records but the information is inaccurate. For example, Wake County records show the Old Revenue Building was built in 1927 and has never been renovated and that the Court of Appeals building was built in 1913 and renovated in 1975. Neither is true. The Old Revenue Building was renovated in 1999 and the Court of Appeals was renovated in 2015
- To support its position, the PED report references data from a study commissioned by the McCrory Administration to determine deferred maintenance costs/deficiencies in state-owned facilities. However, the study's report states that the data they produced were not based on a "true representation" of all state-owned buildings but rather a sample of ten buildings in downtown Raleigh

Additionally, due to the complex nature of the study that PED recommends, the Department of Administration likely does not have the resources or expertise necessary to complete the study.

The OSA has not audited or verified any of the figures in the PED report. When questioned about the data, it became obvious that little to none of the data was audited or has been confirmed using reliable sources.

The information needed to establish and enforce space utilization criteria needs to be obtained, but it will be a time-consuming and complicated effort. That effort should probably be a study itself to determine the "how" and "by whom" the PED recommended project should be conducted.

Efficiency Opportunity 2: Transitioning employees from state-owned property to leased properties in lower-cost locations.

Recommendation 2: The General Assembly should direct the Department of Administration to evaluate alternatives to reduce facility management costs and generate additional revenues through more effective use of state-owned and leased office facilities.

State Auditor's Response:

The OSA agrees with the PED's above recommendation that this topic has the potential to produce savings and one-time revenues for the state given the following:

Some buildings surrounding the State Capitol are occupying high-end real estate and the occupants of those buildings could possibly perform their duties just as effectively in less expensive real estate. This would result in the state being able to sell or lease these buildings.

Items of Concern:

The data needed to conduct the study outlined in PED's report does not exist or is inaccurate. For example:

- Tax values from Wake County tax records that were used by PED to support their case are inaccurate. As stated previously, Program Evaluation attempted to use tax assessment values from Wake County Tax records but the information is inaccurate. For example, Wake County records show the Old Revenue Building was built in 1927 and has never been renovated and that the Court of Appeals building was built in 1913 and renovated in 1975. Neither is true. The Old Revenue Building was renovated in 1999 and the Court of Appeals was renovated in 2015
- Deferred maintenance costs, used in Exhibit 6 of the report is self-reported by agencies and not verified or confirmed by the Department of Administration

Additionally, due to the complex nature of the study that PED recommends, the Department of Administration likely does not have the resources or expertise necessary to complete the study.

The OSA has not audited or verified any of the figures in the PED report. When questioned about the data, it became obvious that little to none of the data was audited or has been confirmed using reliable sources.

Efficiency Opportunity 3: Utilization of contracted services to perform additional facility management services on state-owned facilities.

Recommendation 3: The General Assembly should direct the Department of Administration to perform a business case analysis of facility management services performed on state-owned property under the management of the Department of Administration.

State Auditor's Response:

The OSA agrees with the PED's above recommendation that this topic has the potential to produce savings for the state given the amount of funds spent annually ($152.8 million) to ensure the operability of state-owned facilities.

Items of Concern:

- The PED's report points out that the Department of Administration's Facility Management Division accounted for only $30.9 million of the $152.8 million expended to ensure operability of state-owned facilities. There is no accountability for the Facility Management Division's 154 positions and how they spend their time. Therefore, there is no way to know if they could have provided more services and reduce the amount of contracted services

- The OSA is not aware of any processes or oversight that holds contractors accountable for the quality of the facility management services they provide. If the current standards of service are not what they should be, the cost to get those services to an acceptable level could result in additional costs
- The study needs to be done; however, the assumption that there will be cost-savings or that cost-savings will be significant should not automatic
- Most importantly, currently the data needed to effectively complete a business case analysis of facility management services performed on state-owned property under the management of the Department of Administration does not exist

Additionally, due to the complex nature of the study that PED recommends, the Department of Administration likely does not have the resources or expertise necessary to complete the study.

The OSA has not audited or verified any of the figures in the PED report. When questioned about the data, it became obvious that little to none of the data was audited or has been confirmed using reliable sources.

Efficiency Opportunity 4: Increased Compliance with State Term Contracts

Recommendation 4: The General Assembly should direct the Department of Administration to monitor enforcement of statutory compliance with the state term contract utilization requirements by state agencies.

State Auditor's Response:

The OSA agrees with the PED's above recommendation. However, there are no assurances that accurate and reliable information exists to do so.

Efficiency Opportunity 5: More effective use of competitive bidding for contracted services.

Recommendation 5a: The General Assembly should direct the Department of Administration to procure and implement a contract management system for state agency-administered contracted services.

Recommendation 5b: The General Assembly should direct the Division of Purchase and Contract to require state agencies to obtain a 10% reduction from the annual value of the original contract as a condition of awarding an amendment to a contract that extends the period of time in which a service provider is authorized to expend funds.

State Auditor's Response:

The OSA agrees with the PED's above recommendations.

Efficiency Opportunity 6: Effective use of telematics data and Recommendation

Efficiency Opportunity 7: Reduced of cost of incoming mail processing and Recommendation

Efficiency Opportunity 8: Reducing cost of outgoing mail and Recommendation

Efficiency Opportunity 9: Increased use of presort contracts for outgoing mail postage charges and Recommendation

State Auditor's Response:

As stated earlier, the OSA did not have ample time to delve into all of the assumptions made and data used in the PED's report. As such, no responses could be provided related to efficiency opportunities 6 through 9. Instead, the OSA focused our review on the efficiency opportunities with a potentially greater impact for cost-savings.