

Activity of Riigi Kinnisvara AS in managing office space leasing

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Summary

The government owns office buildings valued at about EEK 1.2 billion, accounting for over one fifth of the aggregate value of state-owned buildings. Until now the upkeep and management of office buildings have mainly been the duty of ministries and their subordinate agencies.

In order to release government agencies from the obligation to maintain and develop real estate, the Government of the Republic established Riigi Kinnisvara AS (Public Limited Company Government Real Estate, hereinafter "GRE") in 2001. The purpose of the GRE in respect of office buildings was to save on maintenance costs through returns to scale and provide renting services to government agencies for an optimum price/quality ratio.

The audit revealed that the GRE had developed requisites for sustainable management of office buildings and provision of renting services for an optimum price/quality ratio to public sector institutions. The structure of real estate maintenance costs is comparable to that of other real estate companies and administrative expenses per unit of area at current capacities are equal to other similar objects. The GRE provides office space to government agencies for a rental which, on average, is below the market price.

However, the State Audit Office (SAO) is of the opinion that the purpose for the establishment of the Government Real Estate PLC has not been achieved with regard to office buildings. Only three ministries have been busily transferring buildings to the GRE and are currently renting office space from the company. New buildings or customers of any meaningful amount have not been added since 2003. The Government of the Republic and the Minister of Finance have failed to adopt several decisions which would enable to recognise the output of the GRE's activities in the state budget as saving.

- **There are no definite principles in place for determining the rental price of office spaces** and thus the amount of rent charged from each government agency is agreed individually, not under generally understood criteria. So far the GRE has applied various models and calculations for the computation of rentals. Therefore it is not possible to budget the costs of office space renting country-wide. Transfer of premises to and purchase of renting services from the GRE entails a major budgetary spending on government agencies, because upon re-valuation of assets the value of buildings is usually stated at fair value and this in turn raises the rents charged from government agencies.
- **There are no reliable data** on the second component of budgeting - **the aggregate amount of office space** at the disposal of government agencies. The inquiries made so far reveal that the average office space per employee varies greatly (from 5 to 38 m²) and that government agencies consume, on average, 30 percent more office space per employee than private businesses.
- **There is no overview of the "quality" of state-owned office space or buildings.** Whereas there is an overview of the quality of the property at the disposal of the GRE and only minor shortcomings in quality assessment were identified in the course of the audit, the buildings at the disposal of government agencies have not been assessed in terms of quality. However, in pursuit of sustainability it is essential to keep a reasonable quality level, which, on the one hand, is determined by health and safety requirements for the workplace and, on the other hand, by the needs and opportunities of an agency.
- **The entity responsible for solving the abovementioned problems has not been specified.** The representative of the owner of the GRE is the Minister of Finance, and the Government of the Republic has with its decisions delegated to the Ministry of Finance the authority to resolve a number of issues pertaining to real estate. However, it has not been determined who and to what extent is responsible for the development of a common real estate policy of the government and coordination of action.

As the result of audit findings, the SAO is unable to render an opinion as to whether the transfer of office buildings to the GRE has produced the expected cost effect on the government, because accounting for property maintenance costs in government agencies is deficient. Therefore it is impossible to compare

the expenses of office buildings across state agencies or to those of the GRE facilities. A number of real estate companies operating in Estonia have implemented a common cost accounting standard, which also enabled the SAO to compare the maintenance costs of their office buildings to those of the GRE. There is no similar accounting for buildings under the management of government agencies.

Major proposals

To the Government of the Republic

- Determine how to continue the use of office buildings of government agencies (centralized or delegated management and maintenance; funding of development from the state budget or inclusion of private investments, etc) and how the GRE is to be involved.
- Designate an entity responsible for the general management of state-owned property and authorize it to develop and implement government's real estate policy. The entity implementing the real estate policy must direct the activities of the GRE in the general interests of the government with regard to real estate development, maintenance and reporting. As concerns office buildings, the checks on costs and space exploitation should be centrally organized and the principles for determining rental prices by types of property should be established.
- Consider the introduction of normative office space for workplaces in government agencies. To this end, current exploitation of office space and costs per employee should be analysed in state agencies.

To the Minister of Finance

The Minister of Finance, as the minister administering the stake held by the government in the company, must ensure that the Council of the GRE

- establish a clear-cut model for the calculation of rental charges and the procedure for its application. The price model should take account of the costs incurred for real estate maintenance and the specific features of the types and classes of real property. The price model should also have due regard to the possible transfer to market-based pricing.

The draft audit report was submitted for comment to the Prime Minister and the Minister of Finance. The draft was also submitted to the Chairman of the Council and the Chairman of the Board of Directors of the GRE for notification and statement of their opinions.

The Government of the Republic discussed the draft audit report at its session on 28 July 2005 and decided in principle to support the proposals therein. The Government of the Republic designated the Ministry of Finance as entity responsible for real estate policy. The Ministry was assigned the task to submit to the Government of the Republic, by 30 October 2005, an overview of the activities of and perspectives on development of the GRE.

In his reply, the Minister of Finance stated that he concurred with the proposals made in the draft audit report. For the implementation of the proposals, it has been envisaged to provide general guidelines for the Council of the GRE with respect to the control of maintenance costs of office spaces, assessment of customer satisfaction, classification of lease objects and introduction of a proper price model, and the organisation of reporting on performance indicators relating to the management of office spaces.

The responses of the Chairmen of the Council and of the Board of the GRE prove that the contents and relevance of the proposals have been understood and there is no conflict in views between the two or the Ministry of Finance.

The full texts of the decision of the Government of the Republic, the responses from the Chairmen of the Council and of the Board of the GRE have been annexed to this report.

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