

# Overview of state real estate policy

*Are economical and considered real estate decisions being made in scarce financial conditions?*

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## Summary

**The Estonian state agencies have ca 2.2 million m<sup>2</sup> of building area at their disposal**, the management costs of which totalled approximately 150 million and investments in these buildings amounted to approximately 100 million euros in 2019. Since 2001, the preferred trend of the state has been the handover of buildings and leaseback thereof (together with maintenance services) from Riigi Kinnisvara AS and the acquisition of new premises through RKAS. State real estate is used on the basis of various ownership and administrative relations, and a large part of state buildings are owned by state agencies.

The National Audit Office interviewed the Ministry of Finance as the state real estate policymaker, other Ministries as administrators of state assets and RKAS as the provider of real estate services to determine the pros and cons of state real estate management and whether the Principles of the State Real Estate Policy 2021 approved in April 2021 by the Government of the Republic offers solutions to the problems.

**744 million euros was requested by ministries for real estate investments in 2022–2025.**

**Despite the lack of funds, state budget expenditure related to real estate is not planned in a way that would direct state agencies to find economical and forward-looking real estate solutions from the best tenderer and not from Riigi Kinnisvara Aktsiaselt (RKAS) regardless of the terms.**

**Critical assessment of real estate needs and leasing of premises from the most advantageous tenderer is especially important in a situation where, according to the Ministry of Finance, at least one-third of the money required for the maintenance of state buildings is missing and the main issue may become how to allow the buildings to become dilapidated in a smart way.**

**Although RKAS is competent in the field of engineering and project management, the objective for return on equity determined by the owner may inhibit the provision of the most affordable and flexible real estate services. The money saved on solutions found in the private sector is often taken out of the budget of state agencies.**

**In April 2021, the Government of the Republic approved the new state real estate policy, but immediately after the approval of the document, the Ministry of Finance and other ministries as well as RKAS were of the opinion that it would not solve any fundamental bottlenecks.**

- **Ministries: it is unrealistic to expect RKAS to offer as affordable services and terms to the users of real estate as possible.** According to the ministries, RKAS is competent in engineering but rigid and rather expensive as a partner and does not support the flexible use of buildings should the needs and tasks of the agencies change. The savings from RKAS's joint procurements are questionable, and according to the Ministry of Finance, the price for which RKAS procures construction services from the market is worth analysing. As the owner, the state sets the target for how much return on equity RKAS should make.

- **According to the ministries, many of them are unable to be so-called smart customers who would look into RKAS's pricing and be strong partners to RKAS in negotiating the terms.** It seems that the Ministry of Finance and other ministries have understood their tasks and responsibilities and those of RKAS differently for 20 years. According to the ministries, the real estate reform has emphasised that the RKAS

together with its corresponding staff and not the state agencies are the centre of excellence. On the other hand, according to the Ministry of Finance, RKAS has always been just a technical executor of a smart order, and public agencies decreasing their ability to consider their needs and to negotiate the terms with RKAS has never been the aim.

- **Public agencies usually do not try to find more affordable solutions, rental premises or maintenance service from the private sector as costs related to RKAS and price increases are paid from the state budget by default.** If private sector partners were to raise their prices,

however, the money would need to be found from the internal funds of the agency. The money saved by finding a better-priced solution in the private sector is generally taken out of the agency's budget.

- **The lack of transparency in decision-making regarding state real estate investments at the level of the Government of the Republic devalues the critical assessment of real estate needs for state agencies.** According to the ministries, the slow pace of making financing decisions at the level of RKAS also hinders forward-looking planning.
- **According to RKAS, the government/Ministry of Finance must provide precise guidelines on what RKAS can rely on in its daily decisions on real estate development and repairs** and what is the acceptable condition of the buildings and the 'level' of repairs. RKAS stated that, as a company, they are required to minimise financial risks, but stressed that economical solutions start with a well-considered initial investment in the building, taking into account the lifetime costs, and a realistic and accurate description of the needs of state agencies.

**The lack of motivation and ability of state agencies to be a 'smart customer', the uncertainty of funding and the management of real estate in the current conditions can lead to unreasonable real estate decisions.**

- **According to the ministries, the real estate policy approved by the government in April 2021 cannot be continued. Instead, the Ministry of Finance whose task is to submit proposals to the government for the improvement of real estate management is expecting a clear position from the government on the changes that should be made in state real estate management.** The state real estate reform has been ongoing for 20 years. The main bottlenecks of the field are known, but the solutions have been progressing very slowly. According to the ministries, one reason for this is that the plans and discussions of real estate policy have been mostly theoretical. According to the Ministry of Finance, the successful implementation of real estate policy has also been hindered by the lack of money for the development of necessary information systems and the shortage of people in the Ministry of Finance.

### **Recommendations to the Minister of Public Administration and the Minister's response**

**The National Audit Office recommends the Minister of Public Administration in cooperation with the Minister of Finance, at the latest by the time of preparing the State Budget Strategy 2023–2026, to:**

- going forward, finance real estate expenditure from the state budget in such a way that it encourages renting premises for state agencies and purchasing real estate maintenance services from the best tenderer and not from RKAS regardless of the terms, also to require state agencies to assess real estate needs in a critical and forward-looking manner and to encourage this through transparent funding decisions and implementation of other relevant measures;

The Minister of Public Administration agreed with the recommendation. The Minister emphasised that finding the most affordable real estate solution is the responsibility and freedom of the customer of the real estate environment (usually an agency in the area of government). The Minister did state, however, that in part, the use of funds planned for real estate expenditure for the area of government should be more flexible, and a reasonable solution is being sought.

- find opportunities at the level of the government to reduce the disincentive effect of the terms and conditions (incl. expectation of return on equity) set by the state on the efficient use of real estate, while maintaining the (engineering) knowledge and skills of a centre of excellence;

The Minister noted that the state aid rules of the European Union must be taken into account in determining return on equity, but there are other ways to influence rent payments, for example the size of the repairs component, capital component, terms of lease agreements, etc. The Minister confirmed that in 2022, the plan is to analyse the financing model of RKAS to find ways to reduce costs and increase flexibility in lease agreements entered into between state agencies and RKAS.

- provide state agencies, where possible, with some long-term information/certainty on the financing of real estate investments, as this would help to better plan real estate investments and day-to-day maintenance; and to implement the works of stage II of the development of the state real estate register as soon as possible and develop the real estate register and management plans into a uniformly functioning tool in order to reduce manual labour.

The Minister substantively agreed with the recommendation and confirmed that the 10-year plan for investments in built-up real estate will be prepared within the framework and as part of drawing up the State Budget Strategy 2023–2026. Stage II of the development of the state real estate register has received a positive preliminary decision, and if everything goes according to the plan, management plans of state real estate can be prepared for the first time based on the register as part of preparing the State Budget Strategy 2025–2028.

**The National Audit Office recommends the Minister of Public Administration** to prepare and submit to the Government of the Republic an updated state real estate policy, which describes the goals aimed at making real estate management more efficient and using the funds more expediently and outlines the specific activities together with time schedules, cost estimate and the persons responsible.

According to the Minister, no update of the state real estate policy is currently planned, instead the focus is on implementing the principles of the real estate policy approved by the government in April 2021. The Minister's response shows that, in the opinion of the Ministry of Finance, the issues, objectives, activities, responsible persons and deadlines related to real estate are stated in the policy document clearly enough and the criticism of ministries addressed by the National Audit Office in the overview points to (merely) the shortcomings in communicating the policy.

Comment by the National Audit Office: as the representatives of all eight ministries found in discussions with the National Audit Office that the current state real estate policy is not specific enough for implementation and/or fundamental issues (for example, the tasks and responsibilities of agencies, size of the budget, and flexibility) require further discussion, better communication may not be enough. The National Audit Office finds that one way or another, the objectives, activities, financial means/cost estimates, responsible persons and deadlines of real estate policy must be specified in order to effectively manage the field and assess the development.