

California State Auditor

B U R E A U O F S T A T E A U D I T S

The Los Angeles Unified School District:

*It Made Reasonable Decisions in Moving Its
Business Services Center, but Must Act Soon
to Successfully Relocate to a Permanent Site*



October 1999
99114

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CALIFORNIA STATE AUDITOR

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October 28, 1999

99114

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the Los Angeles Unified School District's (district) decisions surrounding the move of its business services center in 1995.

This report concludes that the district made a reasonable decision in moving its business services center, and that its choice of replacement buildings appears defensible. However, its process lacked an independent evaluation of the information and recommendations provided by its private consultant, a real estate broker. It is not prudent for a public agency to rely exclusively on someone who benefits from a transaction. Further, although the district's lease ends in March 2002, it has just recently started to consider where it will move next. The district needs to act quickly to successfully relocate its employees to a permanent site. Finally, the majority of funding the district received for its business services center was appropriate. However, a miscommunication led to the inappropriate award of more than \$130,000 by the State Allocation Board.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

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SUMMARY

Audit Highlights . . .

Our review of the Los Angeles Unified School District (district) revealed:

- ☑ *The district made a reasonable decision to move its business services center.*
- ☑ *Although its choice of buildings appears defensible, the district's process lacked an independent evaluation of its broker's information and recommendations. It is not prudent for a public agency to rely exclusively on someone who benefits from a transaction.*
- ☑ *The district's lease ends in March 2002; however, it has only recently started to consider where it will move its business services center.*

Moreover, the majority of funding awarded to the district for its business services center was appropriate. However, a miscommunication led to the inappropriate award of more than \$130,000 by the State Allocation Board.

RESULTS IN BRIEF

The Los Angeles Unified School District (district) made a reasonable decision to move its business services center, and its choice of buildings appears defensible. In October 1994, following the Northridge earthquake, engineers hired by the district found that the building housing its business services center had structural flaws even though it suffered relatively minor damage from the earthquake. The engineers' review determined that these flaws could cause specific sections of the building to collapse if a moderately strong earthquake took place closer to the building. Concerned for the safety of its employees, the district's Board of Education (board) declared an emergency and relocated the employees and services from the building. Retrofitting while the employees stayed in the building was not a viable alternative because of the risk of injury or death should another earthquake occur.

Thus, the decision to move the business services center was reasonable, but the district's need to move quickly gave it little time to look for a new location. Further, the district's desire to keep its staff housed together limited its choices. In spite of these limitations, it appears that the district selected the most favorable alternative from the options it determined to be suitable. However, we did find that the district's process of selecting a building lacked an independent evaluation of its cost assumptions and of the information provided to it by its real estate broker. The district relied heavily on its broker to identify and analyze its relocation options, even though the broker stood to benefit from the transaction. It is not prudent for a public agency to rely exclusively on someone who stands to benefit from a transaction. This evaluation, independent of the broker, could have been performed either internally or externally, depending on whether the district possessed the necessary expertise.

Its lease at the interim site, the IBM Tower, will cost the district a significant amount of money. We project that this seven-year lease, including parking and relocation costs, will total \$47.2 million. However, after considering offsetting savings

from its former facility and a federal grant, the lease's \$19.8 million projected net cost is close to the \$20.5 million the district initially estimated as its expected net cost.

The district still has challenges ahead: It may find itself facing another hasty relocation if it does not act soon. Only advance planning can ensure timely and cost-effective decisions when relocating a large number of people. Yet with its lease ending in less than 2.5 years (March 2002), the district has not determined where it is going to relocate the business services center. In March 1999, the district commissioned a study of the best options for the district. However, it has only recently received a draft report of the study, and thus is just starting to consider the consultants' recommendations.

We also determined that the majority of funding awarded to the district for the business services center was for appropriate purposes. The district applied for funds from two federal agencies and one state agency and was awarded, or conditionally awarded, about \$20 million to relocate and retrofit its business services center. However, the district was inappropriately awarded funds of more than \$130,000 because the State Allocation Board did not clearly communicate in its policy the intended purpose for its program's funds.

RECOMMENDATIONS

To make the most of its financial resources, the district should do the following:

- Take prompt action to make cost-effective decisions about where to locate its business services center when its lease expires in 2002 and what to do with its former business services facility.
- Protect its interests in significant financial transactions by obtaining an independent review of information its consultants provide, especially when the district's interests may conflict with its consultants, using a third party if necessary.

To avoid the misuse of state funds, the State Allocation Board's policies should clearly communicate its intentions when it allocates funds for specific purposes. It should also retrieve any funds it inappropriately disbursed, and unobligate funds it inappropriately approved.

AGENCY COMMENTS

The district agrees with our recommendations and plans to take corrective action. In addition, the State Allocation Board plans to discuss the recommendation we directed to it at a future board meeting and take appropriate action. ■

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INTRODUCTION

BACKGROUND

The Los Angeles Unified School District (district) is California's largest school district, with over 913,000 enrolled students in 1998. The district's more than 900 schools and educational centers occupy 11,000 buildings and serve a large area that extends through much of the city of Los Angeles, portions of 29 other cities, and unincorporated areas.

THE NORTHRIDGE EARTHQUAKE SERIOUSLY AFFECTED LOS ANGELES AND THE DISTRICT

On the morning of January 17, 1994, the Northridge earthquake, registering 6.7 on the Richter scale, hit the Los Angeles area, taking 72 lives and causing approximately \$23.8 billion in damages. Los Angeles, Orange, and Ventura counties were declared federal disaster areas. The earthquake affected various Los Angeles community services, including the school district, which reported that 55 percent of its buildings were damaged. After the Northridge earthquake, the district began an evaluation process for its damaged sites, which included submission of damage reports describing the disaster-related damage for relief funding purposes. The Governor's Office of Emergency Services and the Federal Emergency Management Agency (FEMA) prepared over 10,000 damage reports for the district, more than any other applicant in this disaster.

THE DISTRICT'S RECOVERY PROCESS INVOLVED STATE AND FEDERAL AGENCIES

Both federal and state agencies assisted the district in recovering from the Northridge earthquake. These agencies included the U.S. Department of Education, the Office of Emergency Services, FEMA, and the State Allocation Board. The U.S. Department of Education provided funding to restore school instruction lost while district schools were closed and provide counseling and support services to students and staff. The Office of Emergency Services coordinates the State's response to major disasters in support of local government entities such as the district. In

conjunction with the Office of Emergency Services, FEMA offers two types of financial assistance: money from its Public Assistance Program to repair damage caused by the disaster, and funds from the Hazard Mitigation Grant Program to prevent damage from future disasters. In this disaster, FEMA paid for 90 percent of eligible costs to repair earthquake damages through the Public Assistance Program and required recipients to match the remaining 10 percent from other funds. Affected school districts could apply for the remaining 10 percent from the State Allocation Board, which allocates state resources to local school facilities, and which had created a new Northridge Earthquake Program specifically for this purpose. Also, FEMA provided funds from the Hazard Mitigation Grant Program to local districts to remove potential hazards. The Office of Emergency Services and FEMA reviewed applications to determine whether projects would receive funding through the Hazard Mitigation Grant Program.

THE DISTRICT RELOCATED CERTAIN ADMINISTRATIVE STAFF TO A LEASED BUILDING DOWNTOWN

The business services center was originally located near Fifteenth and San Pedro in an older building that was constructed in seven phases, beginning as early as 1915. The district owns this building, which housed many of its administrative functions such as payroll, accounting, information technology, and records storage. In January 1995, the district declared an emergency to relocate over 850 staff from this building, which it considered structurally unsound. The district then leased space in the IBM Tower, a high-rise building in downtown Los Angeles, and relocated the administrative staff from the business services center and another facility to this new site. The seven-year lease for the IBM Tower will end in March 2002. The lease costs vary, ranging from \$8.56 per square foot during the first three years to \$29.47 per square foot during the last three years.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of the Los Angeles Unified School District to review staff actions taken and decisions made regarding the move of the district's business services center. Specifically, we were to determine if the district reasonably

explored alternative options and considered relevant costs. Additionally, we were to determine whether the funding provided to the district for its business services center was appropriate.

To evaluate whether the district's move was warranted and appropriate, we reviewed assessments of the old facility's condition and considered the intent of the district's Board of Education (board) in moving the business services center. We did this through interviews with board members, current and former district staff, and the district's consultants. We also reviewed engineers' reports on the condition of the old facility. Further, we examined memos and analyses, as well as board meeting minutes and tapes to understand the arguments, research, and information used as the basis for making this decision. In addition, we considered the reasonability of liability issues facing the district at the time.

To assess whether the move to its new location was reasonable, we analyzed the assumptions of the district's cost analyses, reviewed the actual costs it incurred to date, examined its analysis of alternate options, considered its long-range planning, and explored its use of outside consultants in making this decision. To do this, we also interviewed current and former district staff and reviewed analyses and documents prepared by the district's staff and consultants.

To determine whether the funding given to the district for its business services center was appropriate, we reviewed the relevant laws, regulations, rules, and policies. Further, we examined pertinent documentation and interviewed staff at the district, Office of Emergency Services, and State Allocation Board to gain an understanding of their roles and actions. ■

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CHAPTER 1

Although the Los Angeles Unified School District Reasonably Decided When and Where to Move Its Business Services Center, It Needs to Act Soon to Successfully Relocate to a Permanent Site

CHAPTER SUMMARY

The Los Angeles Unified School District (district) discovered after the Northridge earthquake in 1994 that its business services center, which housed over 850 administrative employees, was structurally unsound. The district subsequently declared an emergency, leased a building, and relocated its staff to a high-quality office building in downtown Los Angeles. Motivated by safety concerns, the district made a reasonable decision to move the business services center.

Retrofitting while the employees stayed in the building was not a viable alternative because of the risk of injury or death should another earthquake occur. However, the district's need to move quickly limited the amount of time it had to relocate the business services center. Its desire to keep its staff housed in one place also limited its options. Despite these limitations on its selection process, the district appears to have made a justifiable choice of interim buildings. However, we did find that the district's process of selecting a building lacked an independent evaluation of the district's cost assumptions and of the information provided by its real estate broker. The district relied heavily on its broker, who stood to benefit from the transaction, for analysis of the options identified. Nevertheless, the net cost of the district's interim lease is expected to be close to the district's original estimate of \$20.5 million because it was able to reallocate funds from a U.S. Department of Education grant that offset differences between estimated and currently projected costs.

Soon after the initial move, the district began some preliminary planning for permanently relocating its business services center, but more than four years later, it still has not made a decision. If

the district does not act quickly, it may need to make another hasty relocation of its business services center when its current lease expires in March 2002.

THE DISTRICT MADE A REASONABLE DECISION TO RELOCATE ITS BUSINESS SERVICES CENTER

Two separate engineering studies reported that the old business services center building would perform poorly in a closer earthquake similar in magnitude to Northridge.

After two engineering reports indicated that sections of the business services center building would perform poorly in another earthquake similar to Northridge, the district's Board of Education (board) made a reasonable decision to declare an emergency and rapidly relocate its employees. Following the Northridge earthquake, the district began evaluating the structural integrity of its buildings throughout the district. Appropriately, the district concentrated on its school buildings first, and then branched out to the administrative buildings. During this process, the district discovered safety concerns at its business services center.

The district commissioned two engineering studies in 1994 to assess the condition of its facility. The first report, completed in October 1994, stated that the main building housing the business services center suffered relatively minor damage because of its distance from the epicenter of the earthquake, but the observed pattern of damage was indicative of "structural life safety concerns." Further, it stated that the building would perform poorly during a future earthquake of the same magnitude but closer to the site because it does not have a seismic resistance system that meets building codes. The individual in charge of the study told us that these report findings mean that while the building was not severely damaged in the Northridge earthquake, another earthquake closer to the structure and of similar magnitude could cause death or injury because the structure is not up-to-date with current earthquake building standards.

The district commissioned another study, independent of the first, as a second opinion. In November 1994, this second report confirmed the observations of the first and went on to state that sections of the main building would not be able to resist the loads imposed by moderate to major ground motion without severe structural damage or localized collapse. The engineer in charge of the study told us this finding means that during another earthquake similar to Northridge, parts of the building might fall down or be severely damaged if the epicenter is closer to the business services center.

The main building of the business services center consists of three separate structures, built at different times, placed next to one another to create one large building. The three component structures, first begun in 1915, were built in seven phases. The engineers identified significant deficiencies in this building, including floors lacking sufficient stiffness or strength, and other parts of the building being too brittle for earthquake building code standards. Another problem noted by the engineers was that the three component structures were not attached to one another using a method recognized by building codes, so the various structures could have a tendency to pound into one another during an earthquake. The engineering firms' estimates of the cost to repair the building and remove the hazards were as high as \$17 million.

The board's concern for the safety of its employees led to its decision to relocate staff.

In January 1995, faced with the major questions of how to eliminate the hazard to its employees and how fast to act, the board made a reasonable decision to declare an emergency and relocate the staff of the business services center to another building rather than risk deaths and injuries during another earthquake. The board's primary concern was for its employees' safety. The business services center housed more than 850 employees and numerous critical services and records for the district. If parts of the building collapsed during another earthquake, many lives, as well as important services and records, could be lost. Also, if the board failed to mitigate the hazardous conditions for its employees, the board members could be found personally liable for the injuries or deaths.

In the past, the district had looked for alternative sites for its business services center. In 1991, it even went so far as to advertise for a request for proposal on a joint venture that could have included the business services center's relocation. However, regardless of what the district may have considered in the past, we did not find any indication that the district's past thinking dictated its decision to move. Instead, the board's concern for the safety of its employees dictated its decision to declare the emergency and relocate the staff.

The board's declaration of the emergency, prompted by its desire to move quickly, exempted the district from certain state requirements pertaining to its search for a new location. Specifically, the declaration exempted the district from the requirement for advertising for or inviting bids for contracts, which is a provision of the California Public Contract Code. Despite this,

after the board declared the emergency, the district opened up an informal bidding process for nearly a week to obtain any proposals that may not have made their way to the district.

A possible option was for the district to retrofit the building, but because of the board's concern about the safety of its employees, this option would have meant relocating the employees out of the building during construction. At the request of the district, one of the engineering firms proposed a retrofit plan that would allow the employees to stay in the building during the work. However, the engineer who performed the study later acknowledged that while this option was possible, it was not realistic because of the disruption it would cause the district's staff. More importantly, if the district's employees stayed in the building during the retrofit work, they would continue to be at risk of injury or death if another earthquake occurred. Thus, if the district elected to retrofit the building, not only would it have had to incur the cost of retrofitting, but it would have needed to pay the cost of leasing a replacement facility for its employees for some unknown, but potentially lengthy, period of time. When confronted with the significant safety concerns that it faced, the district made a reasonable decision to move its employees as quickly as possible to a suitable facility, and later explore its options for a permanent facility as part of a comprehensive study of its administrative space needs.

Nevertheless, the district's desire to move quickly placed tremendous time constraints on its staff to find an alternate location for its business services center. Between November 1994, the date of the second engineering report, and January 1995 when the board declared the emergency, the district's staff began the initial search for a replacement building by obtaining information about buildings available in the Los Angeles area. On January 23, 1995, the board directed the staff to find a suitable replacement facility and bring it back for review on February 2, 1995. The board also agreed with the staff's intention to find a location that could be occupied by the business services center employees as early as March 1995. By putting such time constraints on the process, the district limited the number of locations it could reasonably explore.

The district's desire to move quickly placed tremendous time constraints on the process of finding a replacement building.

WHEN CONSIDERING THE DISTRICT'S SAFETY CONCERNS, ITS CHOICE OF BUILDINGS APPEARS DEFENDABLE

The district's desire to act quickly to preserve the safety of its employees was the primary limiting factor when it considered what buildings were available to relocate its business services center. In addition, its desire to house its business services center staff in one place also limited the number of buildings available. Given these limiting factors, it appears the district appropriately narrowed its options, then made a defensible choice from its top three alternatives. However, we did find that the district's process lacked an independent evaluation of its cost assumptions and of the information provided by its outside real estate consultant. Because it did not obtain an independent review to ensure that all options were considered, the district cannot be sure there were no better alternatives available.

The District Reasonably Narrowed Its Options and Appears to Have Made a Defensible Choice of Buildings

The District's Eight Criteria for Building Selection

- Immediately usable—by March or April 1995
- Enough space—(250,000 square feet)
- Competitive cost
- Close to employees
- Enough parking
- Operationally suitable
- Close to transportation—i.e., mass transit and freeways
- Offer received

Because the district believed it needed to move its business services center quickly due to safety concerns and wanted to house all its business services center staff in one location, its choices were limited. Within those limits, the district followed a reasonable process of eliminating buildings from a list of those available and making a prudent choice of the least expensive building on its short list of three.

While the district's documentation of its process did not present a clear and comprehensive picture of when and to what extent the district explored its options, we were able to ascertain that the district created and applied eight criteria to a list of 37 buildings its real estate broker provided. These eight criteria contained two very limiting factors: timing and space.

The most limiting criterion was timing. The district wanted a building available for initial occupancy by March or April 1995. This allowed a very short time to find a building and move a large number of people—but the district's concern for the safety of its employees dictated the timing. According to district documents, about 75 percent of the buildings on the list of 37 did not meet the timing criterion. The

district's second limiting criterion was the total amount of space necessary for the move. Believing it was important to keep staff together, the district's management decided that it needed at least 250,000 square feet. It is possible that the district could have separated the business services center staff and relocated them in several smaller buildings, thus expanding its options. However, the district did not explore its options using that criterion, therefore we cannot determine what may have been available at that time, nor do we know whether such an alternative would have been more or less expensive.

The district eliminated buildings from its selection process for various reasons, including concerns over the date space would be available.

In addition to the criteria of whether a building was immediately usable or had enough space, a third criterion was important—whether the district received an offer to lease the building. Based on the documentation the district provided us, as well as interviews with district staff and its broker, only 13 of the 37 buildings appear to have met at least two of these three important criteria. Of these 13 buildings, the district eliminated 6 for a number of reasons, including date of availability, space concerns, seismic concerns, access to mass transportation and freeways, and failure to receive an offer. For example, it eliminated the Pacific Electric building because it thought delays caused by the need to make improvements would render the space unavailable within the district's time frame. The district's reasons for eliminating these 6 buildings appear defensible. See the Appendix for a listing of the 13 buildings that met two of the three most significant criteria and reasons why the district eliminated some of them.

The district then compared the projected occupancy costs and lease durations of the 7 remaining buildings to create a shortened list of finalists. The district felt it needed at least a five-year lease to allow it to plan its next move, but also believed that a ten-year lease was too long. Since the district believed that five-year leases were too expensive, it preferred a seven-year lease, which was offered by 4 of the 7 buildings. For the 3 buildings that offered lease options of both five and seven years, we found that five-year leases were more expensive per square foot by 8 percent to 22 percent per year.

The district forwarded 3 of the 4 buildings with seven-year leases to its short list. The district did not forward the fourth, a historic building, because it had some concerns over how quickly it could obtain building permits and move in. In addition, 1 of the

buildings that did not have a seven-year lease option also offered a purchase alternative, but the district had concerns about this building's configuration and availability for occupancy.

When the board met on January 23, 1995, to discuss the seismic condition and relocation options for the business services center, the district's staff had already identified the three finalist buildings. At that meeting, the district's staff briefly described the selection process; however, a board member expressed concerns that the district may have focused its search too narrowly when it made its choices. The board requested that the search process be opened to acquire information on additional buildings. The district then implemented an informal bidding process for slightly less than a week because the board wanted an update by that time. At a meeting of one of the board's subcommittees on February 2, 1995, the district reported that it had received some new or amended offers, but it still recommended the three original finalists.

We used information the district's broker provided to the district at the time to compare both the total occupancy costs over the term of the lease and the occupancy cost per square foot for the 3 finalist buildings. As shown in Table 1, the district chose the least expensive seven-year lease available from its 3 finalists.

TABLE 1

The Estimated Occupancy Costs of the Three Finalist Buildings

Building Name	Estimate of Total Occupancy Costs Over Term of Lease (Seven Years)	Average Cost Per Square Foot Per Year
1100 Wilshire	\$41.0 million	\$21.62*
IBM Tower	\$38.7 million	\$19.79
AT&T Center	\$44.6 million	\$23.91

Source: Documents prepared by the district's real estate broker.

* Although the district reported that it received a verbal offer on this building of \$20.06 per square foot, it felt that the written offer was the most reliable. The table reflects the written offer.

Although the district chose the least expensive seven-year lease on its short list, the IBM Tower was the district's second choice. Initially, the district chose the 1100 Wilshire building from the short list, but was not successful in its attempts to negotiate a lease for this building. The district was hesitant to lease the IBM Tower because the building is considered to be a premier facility and the district was concerned that public opinion would be negative. However, according to district staff, the IBM Tower offer improved (to the figure in Table 1), and the district decided that the opportunity was too good to miss.

The District Did Not Obtain an Independent Evaluation of Its Alternatives

Although the district ultimately chose its most favorable option from the choices the broker presented, its selection process lacked one significant step: an independent evaluation of the broker's information to ensure the decision's soundness. The district relied on its broker regarding where to rent and what was the best deal for the district. The broker had identified options for the district, visited buildings with the district's staff, and performed cost analyses of different offers. However, relying heavily on information supplied by someone who stands to benefit from the transaction is imprudent, particularly for a public entity. The district's broker benefited from the lease by earning a commission for successfully closing the real estate transaction. Regardless of the short time frame, the district could have obtained an independent evaluation of the broker's information. This evaluation, independent of the broker, could have been performed either internally or externally, depending on whether the district possessed the necessary expertise.

An independent evaluation might have identified \$3.6 million in additional parking costs not included in the initial estimate of lease costs.

This independent evaluation would have helped the district ensure a wise choice of a relocation site by validating or questioning the broker's recommendations and information about neighborhoods and buildings, including the broker's cost analyses. An independent evaluator could offer specific knowledge of the Los Angeles commercial real estate market to give additional assurance that the district considered all options. Further, the evaluator could review the financial analysis to confirm the completeness and validity of costs to the district.

For example, an independent evaluation might have identified expenses that the district's staff did not present to the board when discussing leasing costs. When the district presented the estimated total occupancy costs to the board, it considered the

costs for some parking spaces included in the lease and discussed some additional parking costs, but it did not identify all the parking costs. It should have known these costs were necessary for any lease it signed. We estimated these additional costs to be \$3.6 million over the life of the IBM Tower lease. An independent evaluator might have identified the need to include these costs, given the district's practice to provide free parking for all of its employees. Knowing about the added parking costs might not have affected its decision, but it is reasonable to expect that the board would have wanted to know this information.

The district indicated that its outside legal counsel represented its interests; however, we do not believe this person satisfied the role of independent evaluator.

An additional example illustrates how an independent evaluator may have improved the district's selection process. Tax abatements reduce the district's lease costs because eligible public entities receive tax exemptions when leasing space in a privately owned building. There are different methods of calculating tax exemptions that could affect the estimated abatement amount, and the district accepted an estimate from its broker based on a method not eventually used by the assessor. As a result, the district's estimated tax abatements were \$4.4 million above the actual abatements it is expected to receive by the end of the lease. An independent evaluator may have identified the different methods of calculating the tax exemption, thus providing the district a more accurate picture of the costs associated with its move.

We recognize that the district used an outside legal counsel in relocating the business services center; however, we do not believe this person satisfied the role of independent evaluator. The role of the district's outside legal counsel was to review engineering reports and consult with the engineers to determine the severity of the seismic concerns of the business services center, to obtain a broker to find relocation options, and to be involved in lease negotiations. District staff indicated that they thought the outside legal counsel fulfilled the role of the independent evaluator and represented the district's interests in this transaction. However, when we asked the district for evidence that this person performed the kinds of analyses we would expect of an independent evaluator, it could not provide any. Further, we observed a financial relationship between the district's outside legal counsel and the broker. Since the broker ultimately paid the counsel for the counsel's services during this transaction, at the district's request, we believe that this individual was not independent.

THE LEASE AT THE IBM TOWER IS PROJECTED TO COST THE DISTRICT \$19.8 MILLION AFTER ADJUSTING FOR OFFSETTING SAVINGS

The seven-year lease at the IBM Tower will require the district to spend a significant amount of money. However, the \$19.8 million projected net cost of the lease—after adjusting for offsetting savings from its former facility and a federal grant—is close to what the district initially estimated as its expected net cost.

As shown in Table 2, we project that total occupancy costs through the life of the lease will be \$47.2 million. This consists of the district’s costs for office and storage space at the IBM Tower, including costs for additional space leased through amendments, improvements made for its relocation to the IBM Tower, and total parking and validations over the seven years of the lease. This parking cost reflects the district’s practice of paying the parking costs for all business services center employees.

TABLE 2

Net Cost to District of the IBM Tower Lease (In Millions)

Lease Costs	
Rent	\$36.3
Improvements	3.8
Parking and validations	7.1
Total Lease Costs	\$47.2*
Cost savings from former building	(13.8)
U.S. Department of Education funds	(13.6)†
Net Cost to District	\$19.8

* The \$47.2 million shown differs from the district’s initial estimate of \$38.7 million in Table 1 primarily because the actual savings from tax abatements were \$4.4 million less and actual parking costs were \$4.2 million more than the estimates.

† The district was authorized to spend \$13.6 million from the U.S. Department of Education. However, to date, the district’s records show total expenditures of \$13.0 million, with the remaining \$.6 million pending. The district is attempting to obtain reimbursement for this pending amount.

Fortunately, the district was able to reduce its lease costs in two ways. The district was able to redirect funds it planned to use for its former business services center's operations and maintenance and to use money from a federal grant to pay lease costs at the interim site. Prior to its move to the IBM Tower, the district paid to operate and maintain its former business services center. However, after the move, the direct costs of maintaining and operating the IBM Tower were included as a part of the lease. Therefore, the district was able to use funds set aside to operate the former business services center facility to pay for part of the lease costs at the IBM Tower. Based on district documents, we calculate these cost savings at \$13.8 million over the life of the lease.

After considering off-setting savings, the net cost for the IBM Tower lease of \$19.8 million is close to what the district initially expected to pay.

As discussed further in Chapter 2, the district was able to redirect \$13.6 million from a federal grant, money it would not otherwise have used, to pay some costs associated with the new location. The U.S. Department of Education originally intended this \$88.5 million grant to pay for restoring the days of instruction lost due to the Northridge earthquake, as well as for certain other costs. When the district spent less than it anticipated for those purposes, it applied to spend some of the money on the costs of relocating the business services center. Its request was approved. This allowed the district to use grant funds to pay for the majority of the first three years of the lease rental as well as for improvements to the building and other relocation costs. As a result, the district is expected to pay \$19.8 million of the \$47.2 million in total lease costs from its own funds in addition to the \$13.8 million redirected from its former facility.

The net cost for the IBM Tower of \$19.8 million is expected to be close to the district's initial estimate of \$20.5 million in spite of differences between its estimated and actual costs. Individual costs and savings the district estimated when it decided to move into the IBM Tower differ from its actual costs and savings to date, as well as from recent projections for costs through the end of the lease (March 2002). Specifically, the greatest differences in estimates are for tax abatements, parking, and cost savings. As discussed previously, the tax abatements reduce the lease costs because the district, as an eligible public entity, receives a tax exemption when leasing space in privately owned buildings. However, the district's estimates of the tax abatement savings were higher than the amount of the actual savings it is receiving. Additionally, the parking estimates were lower than actual costs, and some other cost savings did not materialize. These three factors accounted for nearly \$13 million in net costs

that were higher than the district originally estimated, an increase that was absorbed by the \$13.6 million in redirected grant funds.

THE DISTRICT MAY HAVE TO MAKE ANOTHER HASTY RELOCATION

The business services center's first emergency relocation was outside its control. If the district does not act decisively to move its business services center, its next hasty relocation will not be caused by events outside its control, but will be the result of the district's failure to put its consultants' advice into action. In 1995 and again in 1999, the district commissioned studies to advise the board and district staff on how to address this problem and to develop an asset management plan. However, after the first study, the district decided it needed another study before making any decisions. It recently received a draft report of the second study and is just starting to consider these consultants' recommendations.

When faced with moving a large facility, public entities should develop an action plan soon enough to ensure decisions are timely and cost-effective. Although it began some preliminary planning for the business services center's next relocation soon after moving to the interim site, the district has not yet decided how it will address its need for a new site. The district requested its first study of future location options as part of a larger asset management study that began shortly after it moved to the IBM Tower. This study apparently took place over several years. Based on what seem to be printouts of a presentation, it appears that the consultants who undertook this asset management study discussed with the district some broad options identified during this study. However, the district decided that it needed another study before deciding where to relocate its business services center.

The district's lease ends in March 2002; however, it has only recently started to consider where it will move its business services center.

In March 1999, three years before the end of the interim lease in March 2002, the district hired other consultants to develop a long-range plan for its administrative space. The district has only recently received a draft report of this study and started to consider where it will move its business services center. This study was to include options for the business services center as well as the district's other administrative offices. The district could buy, build, or lease separate sites for its various administrative offices, or consolidate and house them at one location.

The draft study recommended that the district seriously consider consolidating its administrative functions. Also, the consultants found constructing a building to be more expensive than buying or leasing space. The consultants concluded that leasing appears to be the best economic arrangement because they found that lease rates at this time are very favorable. They also indicated that if the district were to decide to construct a building, it does not have enough time to do so before its interim lease ends, so it would need to extend its interim lease at the IBM Tower for at least one year at 90 percent of the market rate. They estimate the district will pay nearly \$29 per square foot for this additional year. This is 44 percent higher than the average rate over the term of the current seven-year lease—\$19.79 per square foot as shown in Table 1—which the district was willing to pay for its interim facility.

The district may have restricted the options it can reasonably pursue because of the limited time before its lease expires.

Although the study states that the selection process must begin soon, the district is just starting to consider what it should do about its future relocation and its old business services center site. We are concerned the district may have limited its options it can reasonably pursue because of the amount of time before the IBM Tower lease expires. Constructing or purchasing a building requires more lead time than finding a leased site would; therefore, leasing may seem more advantageous simply because of the short time available.

With the exception of the IBM Tower site, the district's practice has been to own rather than lease property. However, owning a building, through construction and purchase, takes significant lead time, either to obtain permits and construct a building or to obtain environmental impact studies and negotiate a purchase. If the district wants to own its future business services center site, it needs to make relocation decisions promptly. If it does not decide soon, it may have to pay higher lease rates than it previously found acceptable or limit its available options. Even if the district decides not to own its future site, it should act quickly to ensure that it has sufficient time to make a cost-effective decision.

RECOMMENDATIONS

The district should take prompt action to make cost-effective decisions about where to locate its business services center when its lease expires in 2002 and about what to do with its former location.

During significant financial transactions when the district's interests may conflict with those of its private consultants, the district should protect its interests by completing an independent review of the information its consultants provide, using a third party if necessary. ■

CHAPTER 2

Most of the Funding Awarded to the District for the Business Services Center Was Appropriate

CHAPTER SUMMARY

After the Northridge earthquake, the district applied for relief funds from federal and state sources and was awarded, or conditionally awarded, several sizeable amounts of money. The amount awarded was appropriate, except in one case where there was a miscommunication about how certain state funds could be used. Specifically, the State Allocation Board did not clearly communicate its intention to limit the use of its program funds to school buildings rather than administrative buildings.

As previously mentioned, the district received funding from the U.S. Department of Education to pay most of the business services center's lease rental in its new location during the first three years, as well as for improvements to the building and other relocation costs. In addition, the district applied for financial assistance for its business services center from other federal and state sources. Not all of the district's funding requests were approved, and in one instance, the district has received only conditional approval pending the completion of certain significant actions. Additionally, the district has not performed much of the work necessary to receive most of the funding approved by the Federal Emergency Management Agency (FEMA).

THE DISTRICT APPROPRIATELY USED FUNDS AWARDED BY THE U.S. DEPARTMENT OF EDUCATION

The district's use of the U.S. Department of Education funds for its new location was appropriate. The district received \$88.5 million from the U.S. Department of Education primarily to offset costs of making up lost instruction days following the Northridge earthquake. After spending about 75 percent of the money, the district determined that it would need to return approximately \$22 million to the federal government because it

had not incurred as many eligible costs as originally estimated. However, the district identified a provision in the grant that allowed the funds to be used for interim relocation costs and requested to use some of the remaining grant to offset costs associated with the IBM Tower lease. The district obtained permission from the U.S. Department of Education in November 1995 to use \$13.6 million for most of its first three years' lease costs, as well as for improvements to the building and other relocation costs. We determined that the district clearly explained its intended use for these funds to the U.S. Department of Education before obtaining permission, and that the use of these funds was appropriate.

THE DISTRICT HAS NOT PERFORMED THE WORK NECESSARY TO RECEIVE MOST OF THE FUNDS AWARDED BY FEMA

FEMA approved \$1.3 million to strengthen the structure of the former business services center facility; however, the district has not completed the work required to receive these funds because it has not decided whether to repair that building. A second FEMA award of \$5.6 million cannot be disbursed to the district until it determines what it is going to do with the building. The district applied for these awards under two federal programs administered by FEMA: the Public Assistance Program and the Hazard Mitigation Grant Program. The Office of Emergency Services acted as a liaison between the district and FEMA.

FEMA approved \$1.3 million to strengthen the former business services center facility; however, the district has not decided whether to repair that building.

The district received approval for \$1.3 million in funding for the former business services center facility through FEMA's Public Assistance Program. The main goal of this program is to provide for the repair, restoration, reconstruction, or replacement of eligible applicants' facilities damaged or destroyed by a major disaster. In this disaster, FEMA provided 90 percent of the approved funding and required the remaining 10 percent to be matched from other sources. FEMA awards funds after it inspects the damage, and the Office of Emergency Services is asked to concur with the decision.

In June 1994, FEMA approved funding of \$12,000 to fix minor cracking of plaster and stucco and to repaint some walls, work that the district completed. Subsequently, in January 1996, the district was denied funding for a structural evaluation of the business services center because inspectors concluded that the damage observed was not structural damage. However, the

district convinced FEMA to re-inspect the building and based on this re-inspection, FEMA approved funding for a structural evaluation in May 1996. This evaluation, which was released in August 1996, found that the facility sustained structural damage.

Ultimately, FEMA approved a total of \$1.3 million for the district under the Public Assistance Program. The district was to use these funds for a structural evaluation, as well as to pay for an “epoxy injection process,” which consists of injecting into cracks a substance that hardens and strengthens the weakened building. The Office of Emergency Services did not believe that the epoxy injection process was a sufficient means of repair, so it did not concur with FEMA’s funding in this case. However, concurrence from the Office of Emergency Services is not necessary for approval, and the money was awarded by FEMA.

Further, although FEMA has approved \$1.3 million, the district only received the initial \$12,000. Payment is made only after the required work is done, but the district has not completed any additional work, pending its decision about the building. However, if the district chooses to lease a building, as its consultants indicated is the district’s best economic option, instead of repairing the old business services center building for its own use, it will not receive funding from the Public Assistance Program for the retrofit.

The district received conditional approval for an additional \$5.6 million from FEMA under a second federal program, the Hazard Mitigation Grant Program. The primary goal of this program is to provide funding to remove potential hazards to reduce the risk of future damage and loss resulting from major disasters, such as earthquakes. Initially, in August 1995, the district requested \$21 million in federal funds under this program to construct a replacement building. However, in August 1997, FEMA denied the request because it did not believe the proposal was cost-effective. Eventually, in April 1998, FEMA granted a conditional approval of \$5.6 million to pay the federal share (75 percent under this program) of the cost of retrofitting the building.

An additional \$5.6 million in federal funds is pending the district’s decision as to what to do with its former facility.

However, to receive final approval of this funding, the district has to satisfy certain conditions—one of which is to either demolish or upgrade the building to meet seismic safety standards. The district waited to decide what it was going to do until it received the consultants’ report regarding the appropriate use of the district’s administrative property. However, as we

mentioned previously, the district only recently received a draft of the study and is just starting to consider what to do. While the maximum amount of funds available has been determined by FEMA, the extent to which the district will eventually receive funds under this program is dependent on the district's decision on what to do with its old business services center building.

Based on our review, it appears as though the decisions to approve, or conditionally approve, federal funding for the district were appropriate based on the requirements of the federal programs. However, as discussed in the following section, we found that certain state funds were awarded to the district for purposes contrary to the intent of the awarding agency.

THE STATE ALLOCATION BOARD DID NOT CLEARLY COMMUNICATE THE INTENDED USE OF ITS PROGRAM'S FUNDS

Because it did not explicitly prohibit non-school buildings when it created funding policies, the State Allocation Board did not clearly communicate its intention to limit the use of its Northridge Earthquake Program funds to school buildings only. As a result, the State Allocation Board inappropriately obligated more than \$130,000 in funds for use on a non-school building. As long as these funds are obligated to the district, they cannot be used for other school projects under the Lease-Purchase Program.

The State Allocation Board created the Northridge Earthquake Program as part of the State's Lease-Purchase Program to pay the matching portion of FEMA's Public Assistance Program and relieve local agencies from that burden. According to the chief of Fiscal Services at the Office of Public School Construction, which administers the Lease-Purchase Program for the State Allocation Board, it was intended that funds under the Northridge Earthquake Program be used for school buildings only and not for administrative buildings. However, the policies developed by the State Allocation Board did not state this. The program's policies simply stated that public K-12 school districts were eligible for funding and that funding for projects was based on approved damage reports.

Although the State Allocation Board had the money to implement the Northridge Earthquake Program, it was not set up to administer the program, so it delegated the administration to

The State Allocation Board's policy did not state that school districts' use of earthquake funds was limited to only school buildings.

The more than \$130,000 inappropriately awarded is not currently available for use at schools throughout the State for other projects.

the Office of Emergency Services. In this role, the State Allocation Board only intended to disburse funds to the applicants and rely on the Office of Emergency Services to ensure that the applicants' requests for funds met the policies of the program. Based on the Northridge Earthquake Program's stated policies, the Office of Emergency Services believed that if the district had a building damaged in the earthquake, and that building had an approved damage report, it was eligible for funding from the State Allocation Board's Northridge Earthquake Program. Since the district's business services center, an administrative building, had several approved damage reports filed with FEMA, the Office of Emergency Services concluded that it was eligible for funding through the Northridge Earthquake Program. The district received approximately \$1,200 in state funds through this program (the matching 10 percent of the \$12,000 received under the Public Assistance Program to date) for the repair of its business services center and had another \$132,000 obligated. The inappropriate obligation of these funds means they are unavailable to be used at schools throughout the State for other projects under the Lease-Purchase Program.

RECOMMENDATION

To avoid the misuse of state funds, the State Allocation Board should ensure that its intentions are clearly communicated through its policies when it allocates funds for specific purposes. Further, it should take whatever steps are necessary to retrieve the funds inappropriately disbursed and to unobligate funds inappropriately approved.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



KURT R. SJOBERG
State Auditor

Date: October 28, 1999

Staff: Karen L. McKenna, CPA, Audit Principal
Phillip Burkholder, CPA
Fred J. Bolger
Wendy A. Stanek

APPENDIX

Thirteen Buildings Met Two or More of the District's Three Most Significant Criteria for Selection

Building Name	Immediately Usable	Enough Space	Offer Received	Performed Financial Analysis	Disqualifying Factors, If Any
Top Seven Candidates					
1100 Wilshire	•	•	•	•	One of Top 3
IBM Tower 355 South Grand	•	•	•	•	One of Top 3
AT&T Center 611 West Sixth	•	•	•	•	One of Top 3
433 South Spring		•	•	•	Seven-year lease option available but concerns about timing due to historic status, age of building's systems, seismic status, and parking availability.
Security Pacific 333 South Hope	•	•	•	•	No seven-year lease option. Potential lease with another entity. Potential concerns regarding timing and configuration.
Bullocks Headquarters 800 South Hope		•	•	•	No seven-year lease option. Concerns about timing and configuration.
312 West Fifth		•	•	•	No seven-year lease option. Concerns about the age of the building's systems and the absence of on-site parking.
Remaining Candidates					
Wilshire-Serrano 3699 Wilshire		•	•		Offer received; however, insufficient space available in time frame.
RTD Headquarters 425 South Main		•	•		Offer received; however, not immediately available. Also, concerns about age of building and seismic stability.
Pacific Electric 610 South Main		•	•		Offer received; however timing concerns. Also, concerns about age of building's systems.
Union Bank Building 5200 Century	•	•			No offer received. Also, distant location.
Wilshire Courtyard 5700/5750 Wilshire	•	•			No offer received. Anticipated high rents; not close to employees or transportation.
Hilton Building 5777 West Century	•	•			No offer received. Distant location. Also, poor configuration.

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Agency's response provided as text only.

Dr. Ruben Zacarias
Superintendent of Schools
Los Angeles Unified School District
Administrative Offices
450 N. Grand Avenue
Los Angeles, California 90012

October 20, 1999

Kurt R. Sjoberg
California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

I am in receipt of your draft audit report, "**The Los Angeles Unified School District: It Made Reasonable Decisions in Moving Its Business Services Center, but Must Act Soon to Successfully Relocate to a Permanent Site.**" I appreciate the opportunity to provide the District's response to your findings and recommendations.

Before commenting on the content of the draft report, I would like to take this opportunity to thank you for the thoroughness and professionalism of the staff who conducted the audit. They were untiring in their efforts to fully understand the situation facing the Los Angeles Unified School District in the aftermath of the Northridge earthquake. Their hard work and fair-minded approach are evident in the draft document they produced.

With respect to the two major recommendations contained in the draft report, the District is in agreement with the State Auditor's recommendations. Specifically, our comments are as follows.

Prompt Action on Relocation: We concur that timely decisions must be made to guarantee that a cost-effective relocation of the Business Services Center can take place at the end of the current lease in March 2002. To that end, the Board is scheduled to receive a report from our administrative space consultants on October 28, 1999 regarding the most cost-effective options facing the District. It is imperative that we act quickly upon receipt of that report to implement its recommendations.

Independent Review: We concur with the observation that significant financial transactions require a higher standard of review prior to action. This is particularly true when the District's financial interests may be viewed as in conflict with its private consultants. In cases where the

District's internal staff have insufficient expertise to perform a thorough review of the potential transaction, it is in the District's best interests to secure an independent review by a third party. While we believe that the District's real estate counsel fulfilled this function in the case of the subject lease, we understand the State Auditor's concerns that both the appearance of full independence and the broader scope of review be present in the future use of such independent reviewers.

I can assure you that the District will act quickly to ensure our ability to implement a cost-effective relocation option for the employees housed at the Interim Business Services Center. Once again, thank you for the opportunity to comment on your findings.

Sincerely,

(Signed by: Ruben Zacarias)

Ruben Zacarias

Agency's response provided as text only.

STATE OF CALIFORNIA - STATE AND CONSUMER SERVICES AGENCY
GRAY DAVIS, Governor
STATE ALLOCATION BOARD
1130 K Street, Suite 400
Sacramento, CA 95814

October 20, 1999

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

RE: BUREAU OF STATE AUDITS' REPORT NO. 99114

Enclosed is a response prepared by the Office of Public School Construction (OPSC) to an excerpt from Bureau of State Audits' (BSA) Report No. 99114. The report includes a recommendation addressed to the State Allocation Board (SAB).

As noted in the response, a future board meeting will include a discussion of the primary BSA finding related to the appropriateness of funding costs to repair earthquake damage to the Los Angeles Unified School District's business services center. I can assure you that appropriate action will be taken at that time to address the recommendation presented in the report.

If you need further information or assistance on this issue, please call me at (916) 445-8582, or Luisa Park, Interim Executive Officer, at 445-3377.

Sincerely,

(Signed by: Annette Porini)

ANNETTE PORINI, Chair
State Allocation Board

AP:ed
Enclosure

MEMORANDUM

Date: October 20, 1999

File No.: 99114

To: Annette Porini, Chair
State Allocation Board
State Capitol, Room 1145
Sacramento, CA 95814

From: **Department of General Services
Office of Public School Construction**

Subject: **RESPONSE TO BUREAU OF STATE AUDITS' REPORT NO. 99114**

Based on your request, the Office of Public School Construction (OPSC) has reviewed the findings and recommended actions related to State Allocation Board (SAB) operations that are presented in Bureau of State Audits' (BSA) Report No. 99114. The report contains the results of the BSA's audit of the Los Angeles Unified School District's (LAUSD) move of its business services center. As discussed in this response, the OPSC will take appropriate actions to address the BSA's findings.

In brief, due to the state's fiscal crisis, in February 1995 it was decided that funds from the state's Lease-Purchase Program (LPP) should be made available to fund costs to repair damage to K-12 public schools caused by the Northridge earthquake. Therefore, the SAB created the Northridge Earthquake Program to provide the matching portion to funds provided by the Federal Emergency Management Agency.

The BSA concluded that the SAB's policy approved on February 22, 1995 to implement the above program was unclear as to the restricted use of the funds to only public school buildings. The auditors concluded that this lack of clarity led to an inappropriate disbursement of \$1,200 to the LAUSD for repair of its business services center, which is used as an administrative building. Further, the auditors concluded that an additional \$132,000 has been inappropriately obligated for repair of the center.

The following response only addresses the BSA's recommendation. Since they have been extensively discussed in past meetings with the BSA's staff, our disagreements with some of the information presented in the report will not be repeated in this response.

BSA RECOMMENDATION:

"To avoid the misuse of state funds, the State Allocation Board should ensure that its intentions are clearly communicated through its policies when it allocates funds for specific purposes. Further, it should take whatever steps are necessary to retrieve the funds inappropriately disbursed and to unobligate funds inappropriately approved."

OPSC RESPONSE:

For the first recommended action related to clearly communicating policies, as staff to the SAB, the OPSC continually strives to create clear policies for adoption by the Board. Currently, funding decisions are made only in accordance with policies and procedures that are based upon SAB regulations and are consistent with the underlying law. The process of developing regulations ensures clarity through steps that provide for public comment, SAB review and Office of Administrative Law approval.

In regard to the recommended action related to retrieving and unobligating funds, the OPSC will research the options available to the SAB and present those options at a future board meeting. However, it should be noted that, while at the time of adoption the Board's practice was to fund school buildings only, there is no legal reason or official policy that restricts the funds solely to that use. In fact, provisions within the Education Code give the SAB the authority to allow the use of LPP funds to repair damage to school district administrative buildings. Therefore, the SAB may ultimately decide that it is appropriate to allow the use of those funds to repair earthquake damage to the LAUSD's business services center.

If you need further information or assistance on this issue, please contact me at 445-3377.

(Signed by: Luisa M. Park)

LUISA M. PARK
Interim Executive Officer
Office of Public School Construction

LMP:RG:ed

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps