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INDEPENDENT STATE AUDITOR'S REPORT ON THE DIVISION OF CAPITAL ASSET MANAGEMENT AND MAINTENANCE'S RELOCATION OF CERTAIN STATE AGENCIES

OFFICIAL AUDIT REPORT

JULY 15, 2009

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In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, and at the request of the Honorable State Senator Richard R. Tisei, the Office of the State Auditor has conducted a review of the Request for Proposals (RFP) process administered by the Division of Capital Asset Management and Maintenance (DCAM) for the procurement of leased office space on behalf of the Division of Banks (DOB), the Division of Insurance (DOI), the Department of Telecommunications and Cable (DTC), the Department of Public Utilities (DPU), and the Division of Professional Licensure (DPL). Our specific objectives were to determine whether DCAM administered the RFP process in compliance with applicable laws, rules, and regulations; the proposal evaluation process was thorough, fair, and objective; and conditional selections were decided in the best interests of the Commonwealth and the state agencies involved. We also examined a claim by Equity Office Properties (EOP) that the Massachusetts Bay Transportation Authority (MBTA) risked losing up to $6 million in potential income over the next three years due to EOP's proposals not being selected for leasing office space to DOB, DOI, and DTC.

Our review determined that (1) the RFP process administered by DCAM to procure office space for the DOB, DOI, DTC, DPU, and DPL was conducted properly and complied with applicable laws, policies and regulations; (2) the winning proposals, amended to reflect DCAM's conditions, offered the best value to the Commonwealth and the agencies involved in the process; (3) EOP's claim that the MBTA would suffer a potential income loss of approximately $6 million is unsupported; and (4) there will be savings of an estimated $9.5 million in leasing costs over the next 10 years (the life of the lease) by relocating DOB, DOI, and DTC from South Station to the Washington Street site based on DCAM's cost analysis. In addition, we noted that the MBTA has not received any cash distributions over the past five years from its ground lease with EOP, even though the MBTA is entitled to 50% of net available income and EOP has collected over $40 million in gross revenues during this period. In fact, the MBTA has a current liability to EOP of $337,253 as of December 31, 2008.

Our review indicated that DCAM properly administered the RFP process relating to the procurement of leases for office space on behalf of DOB, DOI, DTC, DPU, and DPL. Specifically, the five state agencies, as required by DCAM, first prepared a comprehensive facility plan that documented each agency's future space needs based on such factors as staffing levels, location needs, and allocation of space. These facility plans became the blueprint for the RFPs that DCAM prepared and issued. DCAM also established a standard proposal evaluation strategy that focused on specific cost and qualitative criteria. DCAM project managers and agency representatives evaluated the proposals and prepared a Proposal Evaluation Sheet (PES) rating the qualitative aspects of each proposal and a cost analysis sheet comparing the costs of each proposal based on net present value. Our review of the PES and cost analysis data prepared by the evaluators determined that the process used to select the winning proposals was thorough and in compliance with established policies and practices. Moreover, based on our review and our discussions with representatives of DOB, DOI, DTC, and DPU, we believe that the RFP process resulted in the best value to the Commonwealth and the agencies involved.

Our review indicated that the winning proposals in the RFP process were selected based on an evaluation of qualitative and cost criteria. Specifically, the selected proposals for DOB, DOI, and DTC were found to be superior to those of EOP in the areas of co-location potential, quality and effectiveness of the work environment, and leasing costs.

As previously noted, EOP took exception to DCAM's decision to relocate DOB, DOI and DTC and contended that DCAM's process in selecting the new property was flawed. Specifically, the MBTA and EOP maintained that the South Station facility should have been given a priority since the MBTA is the equity owner of the South Station facility and therefore should be considered as public space. Furthermore, MBTA and EOP indicated that DCAM was not consistent in the awarding process when it selected the South Station facility for DPU and that the market conditions have changed so dramatically from the time the proposals were initially submitted that DCAM should consider terminating the current RFP processes and re-issuing them. Finally, the MBTA and EOP claimed that the MBTA risked losing approximately $6 million as a result of the agencies' relocation. However, our review determined that these claims were not supported. Specifically, the South Station facility is not considered public space in that, under the terms of its ground lease, its control is vested in EOP, a private entity. Moreover, the selection of DPU for the South Station facility does not appear to reflect a flaw in the award process, and EOP's claim that the MBTA would suffer a potential income loss of approximately $6 million is not supported. In fact, it should be noted that under the provisions and conditions of its ground lease with EOP, the MBTA is to receive a fixed non-deferrable annual rent of $330,000, which has been used to reduce other liabilities that the MBTA has incurred as a result of the operation of the South Station facility. However, according to a representative of the MBTA, the MBTA has not received any cash distributions from EOP for the past five years.

INTRODUCTION

The Office of the State Auditor (OSA) has conducted a review of the Request for Proposals (RFP) process administered by the Division of Capital Asset Management and Maintenance (DCAM) for the procurement of leased office space on behalf of the following agencies:

- Division of Banks (DOB)
- Division of Insurance (DOI)
- Department of Telecommunications and Cable (DTC)
- Department of Public Utilities (DPU)
- Division of Professional Licensure (DPL)

Except for DPU, all of the state agencies cited above are under the direction of the Office of Consumer Affairs and Business Regulation. DPU, formerly part of the Office of Consumer Affairs and Business Regulation, is now part of the Executive Office of Energy and Environmental Affairs.

This review was conducted at the written request of the Honorable State Senator Richard R. Tisei. As a result of this request, the OSA, pursuant to the authority granted it under Chapter 11, Section 12, of the Massachusetts General Laws, reviewed the facts and circumstances surrounding the decision to relocate DOB, DOI, and DTC from their existing office spaces at South Station to a new location at 1000 Washington Street in the South End of Boston. Senator Tisei requested the OSA to determine whether the Massachusetts Bay Transportation Authority (MBTA), which owns South Station and is experiencing financial difficulties, risked losing substantial operating revenues due to the relocation of these three state agencies.

Background

Since 1999, the Commonwealth, acting by and through the DCAM Commissioner, has leased office space at South Station, a building owned by the MBTA but controlled through a ground lease[1] by Equity Office Properties (EOP), on behalf of four state agencies – DOB, DOI, DTC, and DPU.

[1] A ground lease is a legal contract for the lease of land and of any buildings and other improvements that are on the land. A ground lease contains an agreement that the ground tenant is obligated to pay rent each year to the ground landlord for the use of the land for the duration of the contract (the term). The ground tenant sometimes builds on the land, but the buildings so constructed by the ground tenant, as well as buildings and other improvements that were on the land at the beginning of the term, must be turned over to the ground landlord at the termination of the contract. During the term, the ground tenant, rather than the ground landlord, controls the land.

The lease agreements for these four state agencies expired on June 20, 2009, the end of the 10-year leasing term. Chapter 7, Section 40G, of the General Laws states that leasing agreements cannot exceed 10 years. DCAM, pursuant to the requirements of Chapter 7, Section 40H, of the General Laws, published RFPs in October 2008 seeking proposals to lease space for use by the four state agencies located at South Station plus DPL, whose lease expires on June 30, 2009. Individual RFPs were issued for DOB, DOI, DTC, DPU, and DPL. Each RFP contained a note from DCAM alerting potential proposers to the other RFPs issued and a statement encouraging proposers having sufficient space to house more than one agency in the same building to submit proposals in response to one or more of the RFPs. Overall, 63 qualifying proposals were submitted to DCAM in response to these five RFPs. DCAM and representatives from the five agencies evaluated the proposals submitted, conducted site visits, attended oral presentations of proposals by the proposers, and mutually agreed upon the most advantageous proposals.

Based on these evaluations, DCAM sent two "conditional-selection" letters to the selected proposers at the end of March 2009. One letter was sent to the firm that submitted proposals on behalf of the owners of the 1000 Washington Street site, informing it that their proposal best satisfied the criteria set forth in the RFPs prepared on behalf of DOB, DOI, DTC, and DPL. The other letter was sent to the firm that submitted proposals on behalf of EOP, informing EOP that its proposal best satisfied the criteria set forth in the RFP prepared on behalf of DPU. Each conditional-selection letter identified specific conditions that the proposer had to agree to prior to DCAM's acceptance of the proposal. Both proposers agreed to accept the conditions. DCAM finalized lease agreements on behalf of DOB, DOI, and DTC on June 16, 2009, and on behalf of DPL on June 18, 2009 at the 1000 Washington Street site. DCAM has indicated that it hopes to finalize the lease agreement with EOP on behalf of DPU at South Station by June 30, 2009.

EOP, which won the proposal to lease office space to DPU, publicly expressed their dismay over losing the proposals for leasing office space to DOB, DOI, and DTC. (EOP did not submit a proposal for DPL.) On March 26, 2009, the Managing Director of EOP sent a letter to the Secretary of Housing and Economic Development asking for his help in reviewing the decision to relocate these three state agencies. This letter included an attached analysis prepared by EOP claiming that the MBTA would suffer a potential loss of income of $5.3 million to $6.2 million over the next three years if these state agencies vacated South Station. Because of this potential loss of income and its effect on the financially strapped MBTA, the OSA was requested to conduct a review, the results of which are included in this report.

Review Scope, Objectives, and Methodology

Our special-scope review examined the RFP process employed for procuring leased office space for the five state agencies, four of which currently lease space at South Station. Our specific objectives were to determine whether DCAM administered the RFP process in compliance with applicable laws, rules, and regulations; the proposal evaluation process was thorough, fair, and objective; and conditional selections were decided in the best interests of the Commonwealth and the state agencies involved. We also examined EOP's claim that the MBTA risked losing up to $6.2 million in potential income over the next three years due to EOP losing the proposals for leasing office space to DOB, DOI, and DTC.

In order to accomplish our objectives, we:

- Reviewed RFP documents and all submitted proposals;
- Reviewed proposal evaluation documents, including cost analysis data;
- Reviewed conditional selection letters and other relevant correspondence;
- Interviewed representatives from DCAM, DOB, DOI, DTC, DPU, MBTA, and EOP;
- Reviewed independent audit reports of the ground lease between MBTA and EOP for the past five years; and
- Reviewed correspondence and financial data produced by EOP and the MBTA.

As part of our process, we also reviewed DCAM's Manual for Leasing and State Office Planning, which was developed by DCAM in conjunction with members of the Real Property Work Group established by the Executive Office for Administration and Finance to present and explain DCAM's simplified leasing procedures and to be a practical guide and reference for agency facilities staff and attorneys. The manual describes the role and responsibilities of DCAM and the agency in acquiring and managing leased space; provides guidance for facilities planning and space planning; and explains procedures and use of standard forms and documents necessary for planning, solicitation of lease proposals, and completing and executing a lease.

Chapter 4 of DCAM's manual sets forth the following four basic goals that guide DCAM in its selection process:

> *The purpose of the Commonwealth's Standards for Leased Space are to meet the following goals:*
>
> - *minimize cost;*
> - *improve the quality and effectiveness of the work environment;*
> - *promote equity among Agencies in the utilization and quality of space; and*
> - *expedite the leasing process.*

In addition, specific standards for space planning have been established by DCAM in the following areas: location, space allocation, tenant improvements, building conditions, landlord services, and co-location of agencies.

As part of our review, we met with representatives of the MBTA, EOP, and Transit Realty Associates (TRA) to discuss their concerns about the DCAM's RFP process for DTC, DOB, and DOI regarding the South Station property. These three state agencies, together with DPU, currently occupy approximately 108,000 square feet at South Station; but as a result of the RFP process conducted by DCAM, the DTC, DOB, and DOI have elected to vacate their respective current premises and relocate. For matters that will be outlined later, DPU elected to remain at the South Station location. All four of these state agencies initially entered into leasing agreements in 1999, and the terms of those leases are set to expire in June 2009. It is important to note that although the MBTA is the equity owner of the South Station property, the MBTA in 1988 entered into a ground lease, dated January 28, 1988, with Beacon South Station Associates, L.P. ending on or about December 31, 2024 with two 15-year extension options. In 1997, EOP, through an acquisition of Beacon Properties Corp., acquired control of the ground lease that Beacon Properties Corp. had with the MBTA, and EOP has controlled the South Station property pursuant to said ground lease since its acquisition of Beacon Properties Corp.

Our review determined that (1) the RFP process administered by DCAM to procure office space for the DOB, DOI, DTC, DPU, and DPL was conducted properly and in compliance with applicable laws, rules, and regulations; (2) the selected proposals, amended to reflect DCAM's conditions, offered the best value to the Commonwealth and the agencies involved in the process; (3) the MBTA would not suffer a potential income loss of approximately $6 million as claimed by EOP; and (4) there will be savings of an estimated $9.5 million in leasing costs over the next 10 years (the life of the lease) by relocating DOB, DOI, and DTC from South Station to the Washington Street site based on DCAM's cost analysis. In addition, we noted that the MBTA has not received any cash distributions over the past five years from its ground lease with EOP, even though EOP collected over $40 million in gross revenues during this period. In fact, the MBTA has a current liability to EOP of $337,253 as of December 31, 2008.

REVIEW RESULTS

1. DCAM ADMINISTERED THE RFP PROCESS IN COMPLIANCE WITH ESTABLISHED PROCEDURES AND LEGAL REQUIREMENTS

We determined that the Division of Capital Asset Management and Maintenance (DCAM) properly administered the Request for Proposals (RFP) process relating to the procurement of leases for office space on behalf of the Division of Banks (DOB), the Division of Insurance (DOI), the Department of Telecommunications and Cable (DTC), the Department of Public Utilities (DPU), and the Division of Professional Licensure (DPL). Chapter 7, Section 40G, of the Massachusetts General Laws requires DCAM to solicit proposals for leasing office space for state agencies at least every 10 years. This law requires the Commonwealth, through DCAM, to provide an open, transparent procurement process allowing property owners to competitively propose on leasing real property to the state. It also ensures that the Commonwealth and its taxpayers receive the best value for its money.

DCAM has established policies and standards for state agencies to follow when procuring leased office space, the first of which is the completion of a comprehensive facility plan. The facility plan documents an agency's current and future space needs based on such factors as staffing levels, location needs, allocation of space, etc. This facility plan then becomes the blueprint for the RFP that is prepared and issued. Our review of DCAM's files regarding this solicitation determined that comprehensive facility plans were prepared by DOB, DOI, DTC, DPU, and DPL and that these plans resulted in the final RFPs issued by DCAM in October 2008. DCAM officials indicated that the process for completing facility plans began in the spring of 2008 with the hope of issuing RFPs by July 2008, a full year before the current 10-year leases expired. Although DCAM did not issue the RFPs on behalf of these agencies until October 2008, the RFPs themselves reflected the needs of the agencies as recorded in their agency facility plans.

DCAM also established a standard proposal evaluation strategy that focused on specific cost and qualitative criteria. DCAM project managers and agency representatives evaluated the proposals and prepared a Proposal Evaluation Sheet (PES) rating the qualitative aspects of each proposal and a cost analysis sheet comparing the costs of each proposal based on net present value.

Our review of the PES and cost analysis data prepared by the evaluators determined that the process used to select the winning proposals was thorough and in compliance with established policies and practices. Moreover, based on our review and our discussions with representatives of DOB, DOI, DTC and DPU, we believe that the RFP process resulted in the best value to the Commonwealth and the agencies involved. A detailed analysis, by agency, of the RFP solicitation and evaluation process appears in the Appendix.

2. DCAM AND AGENCY REPRESENTATIVES SELECTED THE WINNING PROPOSALS BASED ON AN EVALUATION OF QUALITATIVE AND COST CRITERIA

Our review indicated that the selected proposals in the RFP process were selected based on an evaluation of qualitative and cost criteria. Specifically, the winning proposals for DOB, DOI, and DTC were found to be superior to those of the MBTA and EOP in the areas of co-location potential, quality and effectiveness of the work environment, and leasing costs, as discussed below.

In their review of the RFP and PES data, the various state agencies and DCAM indicated that one of the qualitative criteria that would be used in evaluating the qualifying proposals would be the ability of proposers to house one or more state agencies. The objective of incorporating a co-location criterion in the evaluation process was to enable these state agencies to achieve greater space efficiencies by sharing in the amount of common and support areas as well as meeting and hearing rooms, thus reducing the total amount of usable space leased and thereby collectively reducing the total cost of occupancy. According to the PESs for those four state agencies under the Office of Consumer Affairs and Business Regulation, the co-location opportunities for the selected proposer were rated as "excellent;" whereas the PESs for the South Station location rated co-location as only "fair" because South Station did not have enough space to accommodate all four agencies.

The South Station proposals also were rated poorly among DCAM and agency representatives in the area of improving "the quality and effectiveness of the work environment." The South Station proposals required relocating the current occupants of the South Station facility, on a rolling basis, to 175 Federal Street in order to complete "landlord improvements" that would be required if the South Station location was selected by the current occupants. In the opinion of the state agencies involved, having to contend with two relocations would be more disruptive to their respective operations, and except for the disruption caused by the initial relocation to the selected proposer's location, DCAM and the affected state agencies considered the successful proposer's proposals to be far more desirable.

DCAM also prepared a detailed cost analysis comparing the leasing costs of each proposal. The South Station proposals came in at a 30% higher leasing rate than the selected proposals. DCAM officials stated that they were surprised that the South Station proposals were so much higher in cost than the selected proposals, particularly considering the prevailing market conditions for real estate. Not only were the proposals higher in cost, but they also did not include as much rehabilitation work as agency officials expected. Current conditions at South Station, according to agency officials, are less than desirable in several areas. For example, elevators are constantly breaking down, restrooms need to be upgraded, lighting is very poor, and windows leak during heavy rain. Only upgrading of the restrooms was addressed in the South Station proposals.

3. OTHER ISSUES RAISED BY THE MBTA AND EOP CONCERNING THE PROPOSAL PROCESS AND THE POTENTIAL FINANCIAL IMPACT TO THE MBTA OF RELOCATING AGENCIES

As part of our review, we examined (a) specific objections that the MBTA and EOP had with DCAM's RFP process for selecting office space and (b) the MBTA and EOP's claim that the decision to relocate the state agencies from the South Station facility would result in potential rental income losses of up to $6 million. The results of our review are discussed below.

a. MBTA AND EOP's Objections to DCAM's RFP Process Do Not Appear to Be Warranted

As indicated previously, DOI, DTC, DOB, and DPU are currently occupants at the South Station location, and their respective leases expired on June 20, 2009. In responding to DCAM's RFPs, EOP submitted two proposals. Under the first proposal, which EOP identified as Scheme 1, EOP proposed to retain the three largest occupants (DOB, DOI, and DPU) by using space vacated by DTC as expansion space for the growth of these three state agencies. In the second proposal, which EOP identified as Scheme 2, EOP proposed to retain all current occupants by keeping the current layout with some minor reconfigurations.

As a result of the evaluation process undertaken by DCAM and the affected state agencies, DTC, DOB, and DOI indicated that they preferred the Washington Street site to the South Station facility. Aside from cost, the selected location also satisfied another principal criterion that made the successful proposer's proposal more advantageous than that of South Station: co-location. Specifically, by selecting the successful proposer's proposals, DCAM was able to co-locate all four state agencies that report to the Office of Consumer Affairs and Business Regulation in a single facility, which, according to DCAM, will create greater operational efficiencies and greater economic savings with the consolidation of usable space (e.g., shared common areas, IT facilities, and hearing and meeting rooms). Such efficiency and cost savings were not achievable under either proposal that EOP submitted.

Nevertheless, EOP took exception to DCAM's decision to relocate DOB, DOI, and DTC and contended that the process used in selecting the new property was flawed. Specifically, the MBTA and EOP maintained that the South Station facility should have been given a priority since the MBTA is the equity owner of the South Station facility and, therefore, it should be considered as a "public space." Furthermore, EOP claimed that DCAM was not consistent in the awarding process in selecting the South Station facility for DPU. The MBTA and EOP also contended that the market conditions have changed so dramatically from the time the proposals were submitted that DCAM should consider terminating the current procurements and re-issuing the RFPs.

Representatives from DCAM that we interviewed stated that the South Station facility was not considered "public space" because, under the terms of the ground lease, control of the South Station facility is vested in EOP, and the agreement between the MBTA and EOP does not expire until 2024, with two option periods of 15 years each. DCAM explained to us that "public space" is defined as space that is owned and controlled by a public entity. DCAM also stated that the spaces at South Station EOP proposed to lease for occupancy to Commonwealth agencies are part of the ground lease premises and are under the "care and control of Equity Office". Therefore, DCAM determined that the space is private office space.

We also discussed with DCAM the issue about the DPU process and how it differed, if at all, from the process used for the other four agencies. Again, DCAM officials strongly disputed the MBTA and EOP assertions that the process was different or that DCAM had deviated from its past practices. Our review indicated that the RFP process administered by DCAM was identical for each agency. The proposal evaluation process resulted in conditionally selecting the proposals that best satisfied the criteria set forth in the RFPs. A major distinction between DPU and the other four state agencies is that the South Station proposals did not accommodate the four state agencies under the Office of Consumer Affairs and Business Regulation. Since DPU is no longer under the Office of Consumer Affairs and Business Regulation, it did not have a need to co-locate with the other agencies.

According to the DPU official involved in the proposal evaluation process, DPU had a desire to stay at South Station because of its central location and its large hearing room on the 4th floor. However, DPU indicated that DCAM was concerned with the higher proposals submitted by EOP for the South Station site. Based on the proposal evaluations and site visits, DCAM and DPU rated the MBTA and EOP proposal as the most advantageous proposal and conditionally selected the South Station site as the winning proposal for DPU. However, the acceptance of this proposal was subject to several conditions, including reducing total rent by approximately 20% from the original proposal, moving DPU offices to the 4th and 5th floors, and providing improvements to lighting and HVAC systems. The selection also required EOP to agree to lease space to DOB, DOI, and DTC for approximately six months beyond June 20, 2009 at no change in the rent. EOP agreed to these conditions as well as several others.

With respect to the concern about re-issuing the RFPs raised by EOP, DCAM indicated that it and the affected state agencies are satisfied with the selection process and believe that the rent to be paid under the new leases, together with the site selected, are comparable to any proposal that DCAM might receive under any new procurement process. Consequently, DCAM does not believe that a reproposing is necessary or appropriate. A spokesperson for DCAM stated that "DCAM used an open, transparent and competitive process for these leases. [EOP] came in 30% higher than the other proposers and failed to meet the space needs of these agencies."

b. EOP's Claim That the Relocation of DOB, DOI, and DTC from South Station Will Result in the MBTA's Losing $6 Million in Potential Rental Income Is Not Supported

The MBTA and EOP also maintained that by selecting a location other than the South Station facility, the MBTA stands to lose up to $6 million in potential rental income over the next three years as a result of the vacancies of DOB, DOI, and DTC as tenants. EOP maintains that under the current marketing condition for commercial space, it would be reasonable to assume that it will take approximately three years and considerable renovations to lease the vacated space to new tenants. Accordingly, EOP projected lost income to the MBTA of $2.4 million each in years one and two, and $1.2 million in year three. In order to ameliorate these losses to the

MBTA, EOP resubmitted combined proposals for DOB, DOI, and DTC that was approximately 20% lower than its original proposals for these three state agencies. They resubmitted these proposals without solicitation from DCAM and after the selected proposers had already received their conditional selection letters. DCAM, by letter of April 15, 2009, returned EOP's resubmitted proposals, stating that it "cannot accept additional proposals or unsolicited modifications of submitted proposals." Again, it should be noted that EOP's resubmitted proposal did not include any space allocation for DPL.

As part of this review, we also examined the ground lease that the MBTA has with EOP to manage South Station. According to the terms of the ground lease, the MBTA shall receive 50% of net available income, as determined through an audit, each calendar year from revenues generated by EOP's operations at South Station. The MBTA must receive a minimum rent payment of $330,000 each year from EOP, even if 50% of net available income is less than this amount. However, our review of audited financial statements of the ground lease between the MBTA and EOP revealed that the MBTA has not received any cash distributions from the South Station property since 2003 and that, as of December 31, 2008, the MBTA had a cumulative negative obligation owed to South Station of $337,253. Consequently, although the loss of these three tenants will result in less rental income for EOP until new tenants are found, EOP has not, in our opinion, adequately demonstrated the real economic impact that it will have on the MBTA. Furthermore, EOP's claim that it will take three years to lease this space is unsupported and speculative.

It should be noted that under the terms and conditions of the ground lease with EOP, the MBTA is to receive a fixed non-deferrable minimum annual rent of $330,000 that, according to the schedules we reviewed, has been used to reduce other liabilities that the MBTA has incurred as a result of the operation of the South Station facility. However, according to a representative of the MBTA, the MBTA has not received any income from the South Station facility for the past five years even though four state agencies were leasing over 108,000 square feet of space from EOP during this time. When we asked for an explanation, a representative of TRA stated, "Unfortunately, for each year during the period 2004-2008, the MBTA's expense obligations exceeded its income, thus, the MBTA's net income under the Ground Lease was negative." Based on this information, the OSA has concluded that, even with the relocation of these three state agencies, the MBTA will still be credited with the $330,000 minimum rent each year, which will still be used to offset their annual "expense obligations" to South Station.

We also analyzed EOP's claim that by retaining the leases of DOB, DOI, and DTC at the new rental rate approved for DPU, the MBTA would receive $800,000 annually in net income over the next three years (the period of time that EOP claims that the South Station space could be vacant). According to projected income and expense totals for 2010, EOP estimated that 50% of net available income would amount to $775,000 for the MBTA, which it rounded up to $800,000. EOP then assumed that this amount would be available to the MBTA for each of the first three years of the lease. However, EOP admitted that in projecting these totals it did not include the cost of required tenant improvements that will necessitate additional debt financing. Additionally, EOP noted that its analysis did not include the required principal payments. Including these expenses could reduce the net available income available to the MBTA by approximately $450,000 per year according to EOP's estimated costs for tenant upgrades and EOP's prior year principal payments. Since the MBTA's expense obligations to South Station have averaged approximately $700,000 per year, the amount the MBTA would receive if the state agencies remained still would not cover these expenses. At best, the MBTA would reduce their annual liability to EOP by only a small amount.

Auditee's Response

At the conclusion of our review we provided copies of our draft report to DCAM and the MBTA for comments. DCAM concurred with the results of our review. The MBTA's Assistant General Manager for Development requested that all statements referring to the MBTA not receiving any net cash distributions from the South Station operation over the past five years "be eliminated as it is not the subject of this audit." The MBTA believes that these statements imply that it did not receive any benefit from the ground lease when, in fact, it received the minimum guaranteed rent that was utilized to offset operating expenses. The MBTA further believes that "future net cash distributions will be positive if the three state agencies renew their leases and much worse than in any of the prior five years if they don't."

Auditor's Reply

The OSA believes that it is relevant to note in this report the fact that the MBTA has not received any cash distributions from the South Station operation for the past five years (2004-

2008). We were asked to review claims by EOP and MBTA that the MBTA would suffer a potential loss of income of approximately $6 million over the next three years with the relocation of DOB, DOI, and DTC from office space at South Station. In order to address this claim it was necessary to understand the terms of the ground lease and review prior cash distributions to the MBTA during a period of time when all four state agencies were leasing space at South Station. We never imply that the MBTA receives no benefit from the ground lease and we acknowledge that the MBTA has been credited with its minimum guaranteed rent of $330,000 each of the past five years that has been used to offset its share of operating expenses. The fact that the MBTA has received no cash distributions over the past five years while EOP has collected over $40 million in gross revenues during this period is important to note in any analysis of potential future income to the MBTA.

CONCLUSION

The OSA has determined that the RFP process administered by DCAM to procure office space for the DOB, DOI, DTC, DPU, and DPL was conducted properly and complied with applicable laws, policies, and regulations. The selected proposals, amended to reflect DCAM's conditions, offer the best value to the Commonwealth and the agencies involved in the process. Each of the agency officials we interviewed were satisfied with the proposal evaluation process and felt that the best proposal, based on cost and agency needs, was selected. We also determined that EOP's claim that the MBTA would suffer a potential income loss of approximately $6 million is unsupported. In fact, we found that the MBTA has received no cash distributions from EOP over the past five years, even though EOP was leasing over 108,000 square feet of space to DOB, DOI, DTC, and DPU during this period. We also noted that EOP has collected over $40 million in revenue during this period. Although EOP may suffer some losses in revenue if the vacated space at South Station is not leased timely after December 31, 2009, the MBTA will still be credited with the annual $330,000 minimum rental payment from EOP that can be used to offset the MBTA expense obligations incurred each year.

We also determined that DCAM met three of the four basic goals for procuring space as set forth in its leasing manual. Specifically, the proposals selected will: (1) minimize leasing costs; (2) improve the quality and effectiveness of the work environment; and (3) promote equity among state agencies in the utilization and quality of space. In our opinion, the fourth goal of expediting the leasing process was not met because the four state agencies that will be relocated will not be able to do so at the end of their current leases (June 20, 2009). However, this delay will actually benefit EOP because DOB, DOI, and DTC will be remaining at South Station for a period of approximately six months. This will also allow EOP more time to find new tenants and lessen the time the space may be vacant once the relocation takes place.

APPENDIX

Detailed Review of RFP Process by Agency

Division of Insurance

As part of the Request for Proposals (RFP) process, the Division of Insurance (DOI) initially prepared for Division of Capital Asset Management's (DCAM) use a facility plan that provided DCAM with a general blueprint that DOI wanted considered as part of the RFP process. As reflected in the facility plan, DOI currently occupies approximately 40,000 square feet at the South Station facility and has a staff of 131 individuals. The RFP issued by DCAM for DOI requested proposals from interested parties for approximately 34,000 square feet of office space for 169 employees and limited the search to buildings with adequate on-site security in the downtown area.

In connection with this RFP, DCAM received 10 qualifying proposals with average occupancy rates ranging from $43.65 per square foot to $58.66 per square foot. Each of these proposals was independently reviewed by a project manager from DCAM and a project manager from DOI, who then collectively prepared a Proposal Evaluation Sheet (PES) that assessed the compatibility of the proposed office space to the needs of DOI. Although DOI and DCAM prepared PESs for all of the qualifying proposals, they determined that only seven of the 10 proposals warranted site visits. In addition to the PES data, DCAM prepared a Cost Analysis Spreadsheet outlining the yearly rental expenses for the term of the 10-year lease and a Present Value Total Rent evaluation for each of the proposals received. According to these records, the present value of the total rents to be paid by DOI under these 10 proposals ranged from a low of $6,649,833 with an average occupancy cost of $901,802 to a high of $11,722,927 with an average occupancy cost of $1,583,455.

Based upon the criteria set forth by DOI and DCAM in the RFP and the evaluations of the responses to this RFP, DOI and DCAM elected to issue a "conditional-selection" letter to the proposer that submitted the average occupancy cost of $980,219, or a total present value occupancy rate of $7,255,105. For illustrative purposes, Equity Office Properties' (EOP) proposals were significantly higher. The first proposal (scheme 1) had a present value occupancy cost of $8,955,920 with an average occupancy cost of $1,200,174, whereas the second proposal (scheme 2) had a present value occupancy rate of $9,469,303 with an average occupancy cost of $1,276,988. A comparison of the PESs prepared by DOI and DCAM for the successful proposal and the proposal submitted on behalf of the South Station property revealed that, in the opinion of both DOI and DCAM, the selected proposal was superior in both price and building conditions.

In addition, it should be noted that the PES prepared on behalf of DOI regarding the South Station property contained the following negative comments:

- Although the heating and air conditioning system are both suitable, according to the PES they need to be upgraded, rezoned, rebalanced and updated with new thermostats and controls. This work was not contemplated in the proposals;

- Currently there are two elevators serving the premises. Frequently an elevator is out of service for repair. Upgrade to the elevator service was not contemplated in the proposals;

- Access to the loading dock from the proposed premises is awkward and circuitous; and

- Reduction of usable office space, as a result of co-location of state agencies, would not be achieved.

The DOI project manager who assisted in the feasibility planning and the RFP process indicated that DOI had high hopes that the proposal submitted by EOP on behalf of South Station would be competitive in regard to cost and physical upgrades and improvements but was "shocked" upon receiving EOP's proposals. Not only was the occupancy cost extremely high, there were no plans for rehabilitation or construction to make the space better suited for DOI's use; there was no logic to the floor plan presented; and it proposed splitting units and tripling up on office space. EOP's plans were also going to inconvenience DOI, which would be required to move to another location while EOP painted the walls and installed new carpet. DOI felt that the EOP proposals would be very disruptive to DOI's workflow. The project manager also indicated that DOI was not overly impressed with EOP's presentation to the state evaluation team. In general, DOI felt that the EOP proposals were not responsive to its needs and that neither proposal contained a solution to the lack of security regarding the storage of DOI's confidential files. The basement area where DOI stores some of its files is a shared area with other tenants in the building, including railroad personnel. DOI's historical confidential files are stored in this area, and DOI is concerned about potential access to these files by non-DOI employees. According to DOI, EOP did not address this issue in either of its proposals.

DOI felt the RFP process was very thorough. Group meetings were held to discuss the various proposals; site visits were conducted; lengthy conversations were held with DCAM. The property selected through the RFP process met DOI's needs, was significantly less expensive than South Station, was going to be built out to agency specifications, allowed the sharing of space among agencies, would include updated bathrooms, a secure storage space, and a hearing room located on the ground floor. DOI's Commissioner and other top executives visited the selected property and agreed with the selection. Finally, the project manager stated that a lot of thought went into this decision and that the positives outweighed staying at the South Station location.

Department of Telecommunication and Cable

As part of the RFP process, the Department of Telecommunication and Cable (DTC) initially prepared for DCAM's use a facility plan that provided DCAM with a general blueprint that DTC wanted considered as part of the RFP process. As reflected in the facility plan, DTC currently occupies approximately 8,000 square feet at the South Station facility and has a staff of 44 individuals. The RFP issued by DCAM for DTC requested proposals from interested parties for approximately 8,400 square feet of office space for an identical number of employees and requested that the search area be in the downtown area. Access to public transportation was also one of DTC needs since its employees, consumers, industry representatives, agency personnel, and other interested parties who attend hearings need to have easy access to the DTC location.

In connection with this RFP, DCAM received 18 qualifying proposals with average occupancy rates ranging from $41.40 per square foot to $82.42 per square foot. Each of these proposals were independently reviewed by a project manager from DCAM and a project manager from DTC who then collectively prepared the PES that assessed the feasibility of the proposed location to the needs of DTC. Although DTC and DCAM prepared PESs for each qualifying proposal, it was determined by these agencies that only eight of the 18 proposals warranted site visits. In addition to the PES, DCAM prepared a Cost Analysis Spreadsheet outlining the yearly rental expenses for the term of the 10-year lease and a Present Value Total Rent evaluation for each of the proposals received. According to these records, the present value of the total rents to be paid by DTC under these 18 proposals ranged from a low of $2,685,075 to a high of $5,215,525.

Based upon the criteria set forth by DTC and DCAM in the RFP and the evaluations of the responses to this RFP, DTC and DCAM elected to issue a conditional-selection letter to the proposer that submitted the lowest average occupancy cost of $363,288, or a total present value occupancy rate of $2,685,075. A comparison of the PESs prepared by DTC and DCAM for the successful proposer and the proposal submitted on behalf of the South Station property reveal that, in the opinion of both DTC and DCAM, the selected proposer's proposal was superior in both price and building conditions. In addition, it should be noted that the South Station PES prepared on behalf of DTC contained substantially the same issues as those of the DOI project manager, and similar to our exercise with DOI, we contacted DTC's property manager for her comments.

According to the project manager, DTC believes that the proposal evaluation process was thorough and that the selected proposer offered the best space at the best rate. The project manager stated that one of DTC's objectives was to partner with "sister agencies" in order to realize savings through shared space and that the selected site is a "fantastic space," with all new materials, including new lighting and bathrooms. She also stated that the site met all the criteria that DTC and DCAM had required in DTC's RFP, and that current conditions at South Station are less than desirable. Specifically, there is not enough room, resulting in sharing of office space; the working space is poorly lit, and the office layout is poor. Overall, DTC felt that South Station was not suitable for its purposes.

Division of Banks

As part of the RFP process, the Division of Banks (DOB) initially prepared for DCAM's use a facility plan that provided DCAM with a general blueprint that DOB wanted considered as part of the RFP process. As reflected in the facility plan, DOB currently occupies approximately 17,300 square feet at the South Station facility and has a staff of 158 individuals, 90 of whom are located at South Station. The RFP issued by DCAM for DOB requested proposals from interested parties for approximately 20,000 square feet of office space for 90 employees and requested that the search area be in the downtown area. Access to public transportation was also one of DOB needs, as was adequate security, since confidential information is maintained on site. In addition, DOB's facility plan anticipated an increase in staffing and expects that an additional 12 to 15 offices would be needed to house these individuals.

In connection with this RFP, DCAM received 14 qualifying proposals with average occupancy rates ranging from $43.30 per square foot to $70.14 per square foot. Each of these proposals was independently reviewed by a project manager from DCAM and a project manager from DOB who then collectively prepared a PES that assessed the feasibility of the proposed location to the needs of DOB. Although DOB and DCAM prepared PESs for all of the qualifying proposals, it was determined by these state agencies that only eight of the 14 proposals warranted site visits. In addition to the PES data, DCAM prepared a Cost Analysis Spreadsheet outlining the yearly rental expenses for the term of the 10-year lease and a Present Value Total Rent evaluation for each of the proposals received. According to these records, the present value of the total rents to be paid by DOB under these 14 proposals ranged from a low of $6,649,833 to a high of $11,722,927.

Based upon the criteria set forth by DOB and DCAM in the RFP and the evaluations of the responses to this RFP, DOB and DCAM elected to issue a conditional-selection letter to the proposer that submitted its proposal with average occupancy cost of $980,219, or a total present value occupancy rate of $7,255,105. A comparison of the PESs prepared by DOB and DCAM for the successful proposer and the proposal submitted on behalf of the South Station property reveal that, in the opinion of both DOB and DCAM, the selected proposer's proposal was superior in both price and building conditions. In addition, it should be noted that the PES prepared on behalf of DOB regarding the South Station property are substantially the same as DTC's comments reflected above with the following verbal comments received from the project manager for DOB.

Similar to the comments from the other state agencies highlighted above, DOB was hoping that EOP would submit a proposal at a competitive rent with necessary upgrades to its space. However, according to the project manager, DOB was surprised when the EOP proposals came in. Not only were the two proposals submitted by EOP at the high end of the proposals received, both proposals were deficient with respect to rehabilitation work that DOB felt was necessary to address its complaints about conditions in the building. Based on price and amenities, DOB is of the opinion that the best proposal was selected. As far as the project manager is concerned, the only downside to the new location for DOB is that it is not as central to downtown Boston. The South Station location is more convenient, but the selected location is less than a 10-minute walk from South Station, and the winning proposer will be providing a free shuttle service from South Station.

The project manager also indicated that service and maintenance at South Station is not as good as when DOB first moved in 10 years ago. DOB has the same complaints as the other state tenants: poor elevators, bathrooms that need to be upgraded, and leaky windows. Since, according to DOB, the proposals submitted by EOP did not address these issues, a lease with EOP would only result in a continuation of what DOB has now but at a much higher cost. Also, EOP's proposals for DOB called for leasing more space than DOB needed or asked for in the RFP (22,500 square feet vs.

20,000 square feet). The project manager stated that DOB did not like either EOP proposal and reiterated that the new location is to be configured to better serve the needs of DOB. Finally, DOB indicated that the ability to share space with the other state agencies at the new location is a big plus in terms of cost savings.

Department of Public Utilities

As part of the RFP process, the Department of Public Utilities (DPU) initially prepared for DCAM's use a facility plan that provided DCAM with a general blueprint that DPU wanted considered as part of the RFP process. As reflected in the facility plan, DPU currently occupies approximately 35,500 square feet at the South Station facility and has a staff of 183 individuals. The RFP issued by DCAM for DPU requested proposals from interested parties for approximately the same amount of square feet of office space that DPU currently occupies and requested that the search area be in the downtown area. Access to public transportation was also one of DPU needs. It should be noted that in its facility plan, DPU expressed a desire to remain at the South Station location, and since DPU reports to a different Secretariat then DTC, DOB and DOI, the issue of co-location from a DPU perspective was not as paramount as it was with the other state agencies, which all report to the Office of Consumer Affairs and Business Regulation.

In connection with this RFP, DCAM received 10 qualifying proposals with average occupancy rates ranging from $43.65 per square foot to $57.62 per square foot. Each of these proposals was independently reviewed by a project manager from DCAM and a project manager from DPU who then collectively prepared a PES that assessed the feasibility of the proposed location to the needs of DPU. Although DPU and DCAM prepared PESs for all of the qualifying proposals, it was determined by these state agencies that only eight of the 10 proposals warranted site visits. Unlike those prepared by DOB, DOI, and DTC, DPU's PES expressed a priority to remain at the South Station location. In addition to the PES data, DCAM prepared a Cost Analysis Spreadsheet outlining the yearly rental expenses for the term of the 10-year lease and a Present Value Total Rent evaluation for each of the proposals received. According to these records, the present value of the total rents to be paid by DPU under these 10 proposals ranged from a low of $11,475,166 to a high of $15,493,776. Based upon the criteria set forth by DPU and DCAM in the RFP and the evaluations of the responses to this RFP, DPU and DCAM elected to issue a conditional-selection letter to the proposer for the South Station location, subject to certain terms and conditions, including a reduction in the annual rent of approximately 20% from a proposed total occupancy rent of $18,649,335 over 10 years to a reduced total occupancy rent of $14,833,208.

We also interviewed DPU's representative involved in the proposal evaluation process, who stated that since DPU is no longer within the Office of Consumer Affairs and Business Regulation there was no need to co-locate with the other four agencies. He also indicated that DPU preferred to remain at the South Station location because it made sense operationally, since DPU conducts many large hearings involving a diverse group of people, and that the benefits of South Station, without considering cost, were favorable in that it is centrally located and has a large hearing room on the 4th floor. The representative added that he was surprised with EOP's very high proposal and that "it seemed like they missed the market." DPU, which currently leases office space on the 2nd and 3rd floors of South Station, preferred to move to the 4th and 5th floors, currently occupied by DOI. DPU also had many of the same concerns as the other agencies regarding HVAC systems, lighting, and poor elevators at South Station.

Although DPU preferred to remain at South Station, it agreed with DCAM that this would only be possible if EOP agreed to several conditions. EOP agreed to DCAM's conditions, which included a rental amount approximately 20% lower than proposed; upgrades to HVAC systems, elevators, lighting, and bathrooms; and a move to the 4th and 5th floors. The DPU representative also stated that DCAM's conditional selection decision was the best decision for the Commonwealth, the public, and DPU's regulated businesses and that DCAM's final proposal evaluation sheets were "right on the money." Finally, the representative indicated that DPU was pleased that it would not have to be inconvenienced by relocating from South Station during rehabilitation work. DPU will remain on the 2nd and 3rd floors while work is being conducted on the upper floors once the other state agencies relocate.

Division of Professional Licensure

In addition to the other four RFPs that we reviewed, the OSA also reviewed the RFP process conducted by DCAM for the Division of Professional Licensure (DPL). In connection with this RFP, DCAM received 11 qualifying proposals with average occupancy rates ranging from $38.63 per square foot to $57.95 per square foot. It is important to note that of the five RFPs issued by DCAM in October 2008, four (DTC, DOB, DOI, and DPL) were for state agencies under the common control of the Office of Consumer Affairs and Business Regulation. According to representatives of EOP, they did not submit a proposal for DPL; but rather concentrated on retaining the four state agencies currently located in the South Station facility because the facility does not have adequate square footage available to accommodate all five of these state agencies. However, EOP's decision not to submit a proposal for DPL at the South Station location made EOP's proposals for DTC, DOB, and DOI less advantageous than the proposals made by the successful proposer for all four state agencies under the Office of Consumer Affairs and Business Regulation.