

Audit Reports Summaries

Audit Report No. 29 1995-96

Tabled 19 June 1996

Summary

Australian Estate Management

MANAGEMENT OF THE COMMERCIAL ESTATE

Performance Audit

SENATE ORDER

This audit report was undertaken in response to a Senate order of 20 October 1994 as follows:

That a Report by the Auditor-General be laid on the table, as soon as practicable, with respect to the management of property leases under the control of Australian Estate Management as to whether that management is effective and conducted without undue risk to the Commonwealth or distortion of the relevant property market.

Australian Estate Management

Until recently AEM was a Budget-funded element of the Department of Administrative Services (DAS). It managed on behalf of the Commonwealth the Commonwealth's investment in commercial and non-commercial property - 647 properties valued at \$2.5 billion - which were expected to generate annual revenue of \$307 million. AEM also provided policy advice on a broad range of property matters, and administers the Lands Acquisition Act.

Organisational changes

The audit issues examined focused on the operational activities within the AEM structure which were current until the end of April 1996. However, substantial changes to AEM encompassing its management structure, size of the organisation and its operational activities have been recently announced. A new organisation, the Domestic Property Group, will absorb the functions of both AEM and the Australian Property Group.

Audit Objective

The objectives of the audit were to examine and report on the economy, efficiency and administrative effectiveness of AEM's management and administration of the Commonwealth-owned commercial office estate. The ANAO addressed 22 recommendations to AEM, which will remain relevant in the context of the major administrative changes that the Commonwealth's property management function is currently undertaking.

KEY POINTS

Strategic and Business Planning

To provide a better foundation for strategic planning and management, the ANAO has recommended the preparation of discrete strategic, business and operational plans. The ANAO also recommended that AEM define its mission more precisely and take account of Government objectives.

AEM in the Marketplace

The effectiveness of AEM's operations in the market could be further enhanced by improvements in market research and planning activity, with clearer linkages between specific marketing initiatives and the redefined AEM mission. The ANAO recommended that AEM seek appropriate advice on the preparation of market research and on the development of an effective communications strategy.

Portfolio-level Reporting

To improve the transparency of performance results when comparing AEM's results with those of the private sector, AEM should have included in its comparisons imputed costs that are incurred by the private sector but not paid by AEM, e.g. insurances, rates and taxes. In addition, AEM's practices in regard to notional expenses at the individual property level required refinement. This suggested approach would ensure that AEM neither distorts the property market nor enjoys an advantage in this area in comparison with other commercial property owners.

Individual Property Management

From region to region, there are marked variations in the effectiveness and efficiency of AEM's management practices, indicating a need to accelerate the identification and implementation of best practice guidelines as recommended.

Costs of Commercial Operations

The ANAO concluded that AEM expends significantly less than its private sector peers on strategic portfolio management. AEM's property management expenses for individual buildings are about the same as those of its private sector peers in the ACT market (which represents 44 per cent of AEM's office estate by value) but are significantly more expensive in the other regional markets examined, namely New South Wales and South Queensland.

The ANAO suggested that improved financial and performance outcomes could be achieved through a higher focus on strategic portfolio management and by examining options for productivity improvements in individual property management, for example by employing contractors to manage individual buildings or groups of buildings.

Tenancy Arrangements

AEM has experienced significant difficulties in relation to the execution of relevant tenancy agreements with Commonwealth tenants notwithstanding that AEM has expended significant effort in this regard. If unresolved, this situation could have adverse impacts on property values and create uncertainty for strategic management purposes, particularly in an environment where untied clients can move to alternative tenancy arrangements at short notice.

Valuations of Office Estate

The valuation services agreement between AEM and its principal valuer, the Australian Valuation Office (AVO), is regarded by ANAO as meeting industry best practice.

Capital Expenditures

AEM identified significant foreseeable capital expenditures required over the next five years totalling \$848 million. These funds are required to complete approved capital projects and to refurbish existing building stock amongst other things.

Tuggeranong Office Park

The ANAO observed that there were no current plans to address the funding of a minimum of \$194 million representing a shortfall in a sinking fund required in 2008 to repay a number of bond holders and for refurbishment of a large complex of buildings at Tuggeranong presently occupied by the Department of Social Security.

CONCLUSION

A summary of the audit findings is provided below:

- *economy* - AEM's rate of return on capital investment was marginally below a commonly used commercial index (the BOMA Property Index Total Return) in the ACT and NSW, which together represent 68 per cent of its national portfolio by value. However, it was significantly above BOMA in relation to the South Queensland portfolio, which comprises 4 per cent of its national portfolio.
- *efficiency* - AEM could achieve significant efficiencies in running costs. This is particularly pertinent with its move into the fully-commercial environment and in view of the projected administrative changes announced recently.
- *effectiveness* - AEM's performance has been effective in meeting the defined property management objectives of the Commonwealth. However, to meet the changed objectives in the future, improved planning will be required.
- *risk management* - Management of the office portfolio faces a number of significant risks that will require careful management. These include property market risks, financial risks associated with funding the capital expenditure required in the portfolio, risks of increasing vacancy rates and risks inherent in the nature of its commercial property portfolio, which consists essentially of B and C class buildings rather than the more attractive Prime and A class buildings.
- *market distortion* - AEM operated in such a way that it did not distort relevant commercial property markets unduly.

RECOMMENDATIONS

The ANAO made 22 recommendations which focused on improving operational activities, including performance assessment and reporting, which will be relevant to the new structure. AEM agreed with and noted all recommendations, with a number of them already implemented wholly or in part.