ARIZONA STATE SENATE

46TH LEGISLATURE
FIRST REGULAR SESSION

MINUTES OF COMMITTEE ON APPROPRIATIONS

DATE: April 9, 2003 **TIME:** 1:30 p.m. **ROOM:** SHR 109

CHAIRMAN: Senator Burns **VICE CHAIRMAN:** Senator Waring

ANALYSTS: Deborah Johnston, Carolyn Atwater **COMMITTEE SECRETARY:** Tracey Moulton

INTERNS: Benjamin Wing, Christopher Kresge

ATTENDANCE **BILLS**

Committee Members	Pr	Ab	Ex	Bill Number	Disposition
Senator Anderson	X				
Senator Arzberger	X				
Senator Bee	X				
Senator Cannell	X				
Senator Giffords	X				
Senator Harper	X				
Senator Martin	X				
Senator Mead	X				
Senator Rios	X				
Senator Soltero	X				
Senator Verschoor	X				
Senator Waring, Vice Chairman	X				
Senator Burns, Chairman	X				

GOVERNOR'S APPOINTMENTS

Chairman Burns called the meeting to order at 1:35 p.m. and attendance was noted.

APPROVAL OF MINUTES

> **Senator Burns moved the minutes of March 7, 2003 be approved. Without objection, the minutes were approved as distributed.**

Senator Burns commented that there have been negotiations going on with the State Compensation Board relative to their participation in the solution to the budget problem. One possibility is using the Arizona State Compensation Fund (SCF) similar to a holding company to move some assets for the State. He noted that he had invited Dwayne Miller, Chief Financial Officer (CFO), SCF, to prepare some questions as to how this structure would work.

Dwayne Miller, CFO, SCF, commented that he had received an advance copy of their detailed presentation. He stated that from a conceptual standpoint, as a financial professional, it makes a lot of sense. He stated that it is similar to some of the work done recently in terms of evaluating the real estate of the SCF. He commented that there is a tendency of the primary occupant of a building to view it as an operating expense as opposed to an investment. He suggested that the Committee should view these buildings as assets, which are held as investments. Additional opportunities should become more apparent. He opined that there is real potential for the State as this issue is further explored.

Mr. Miller remarked that it may be possible for the SCF to provide some type of assistance in regard to selling any excess assets or any of the other proposals in the presentation.

Mr. Miller asked the following questions:

1). He would like to understand some of the comments on the present state of the commercial real estate market in the State of Arizona and the impact that it would have on the timing of such asset sales or other programs suggested within the presentation.

2). He would like to know what impact will public knowledge have on large asset sale proceeds by the State of Arizona and what the time frame would be for effective disposal of those proceeds.

3). He would like to understand what parties need to be involved for an effective sale of any assets and the general cost and percent of proceeds that these would represent as transactional expenses.

PRESENTATION - Processes for Asset Privatization, Ernst and Young

Jay Pulis, Real Estate Advisory Services Group, Ernst and Young, distributed handouts entitled Real Estate Advisory Services, Arizona Real Estate Privatization Strategy and Real Estate Advisory Services, State Deficit Offset Program (Attachments A and B). He noted that Ernst and Young is one of the largest accounting firms in the country and is a member of a national specialties practice and real estate advisory group, based in Phoenix. He stated that they have 25 full time real estate professionals in the Phoenix Office. He stated that they were present today to talk about helping the State develop a real estate strategy that may help with long range budget deficits, using real estate as a tool to help overcome the budget shortfall that the State is facing in the short term and preparing a database that the Committee can use as a tool to determine what the best strategy is in the long run for the State's portfolio.

Steve Klett, Real Estate Advisory Services Group, Ernst and Young, reviewed the first handout (Attachment A).

Highlights from the presentation:

State Deficit Offset Program

Current State
- Deficit

Closing the GAP
- Asset Repositioning
- Improving Operating Efficiency
- Alignment of Real Estate and Budget Strategies

Future State
- Generate Revenues
- Reduce Costs
- Plan for the Future

Potential Excess Arizona Assets

Assets Arizona should consider for privatization include:
- Office buildings
- Prisons
- Schools
- Excess ADOT ROW or facilities
- State Parks/Campgrounds/Marinas
- Surplus real estate parcels
- Memorial Coliseum/State Fair Site
- National Guard Facilities
- Freeways
- AZ Highways Magazine
- Cash flow from lease income (grazing, commercial lands, marinas, etc.)
- Hospitals

Additional assets may be identified through Ernst and Young interviews and the asset identification process.

Ernst and Young's structured and integrated process would screen and pool assets for retention, sale or lease.

Senator Arzberger asked what the cost was for the first stage of the asset identification process. Mr. Klett stated the firm would propose a retainer, where work would begin under given fixed fees in order to build the database needed for the assessment. He stated that this would be credited back on transaction fees at the end of the process.

Senator Arzberger asked for an estimate of what the service of consultation for identification and creation of schedule and strategy plans would cost. Mr. Klett stated that in the original proposal for 2003-2004, the cost estimate was $200,000 - $250,000 for each year.

In response to Senator Giffords, Senator Burns explained that representatives of Ernst and Young approached him with a presentation on what they would be able to offer. He stated that as negotiations have gone forward with the SCF and the possibility of using the SCF as a holding company, he opined that something like this plan could work with a group such as Ernst and Young. He remarked that the purpose of the meeting today was to give Ernst and Young an opportunity to explain their model of how their system works.

In response to Senator Verschoor, Mr. Miller opined that legislative leadership is exploring a range of opportunities. He stated that the SCF is actively working with them to try to understand how it can participate in some of the budgetary issues in a manner that will protect the interests of its policyholders and be mutually beneficial.

Senator Verschoor asked Mr. Miller if he was in support of a holding company model. Mr. Miller stated that from the SCF standpoint, they are not interested in purchasing and holding real estate. That would be out of their core competencies and that is why they would engage someone like Ernst and Young. He stated that the SCF is focusing on a “bridge financing” concept. He said that looking at the potential proceeds that can be generated makes a lot of sense, speaking as a citizen of Arizona. He opined that there could be some timing issues in terms of matching up an orderly sale with the fiscal year consequences of the State’s budgetary issues. He stated that this is where the SCF could play a role, to help make sure that the funds are received in the fiscal year, yet still facilitate an orderly sale.

Senator Verschoor expressed his concern with basing a budget on $200-$300 million of asset sales when it is still unclear if they are available.

Mr. Pulis agreed with Senator Verschoor and remarked that it is imperative that the State fully understand what assets are truly available. It needs to be done quickly so that there can be an impact in this fiscal year.

Senator Soltero asked if Ernst and Young was providing this service for other states. Mr. Pulis stated that the firm was in talks with approximately a dozen states at this time in regards to this same type of program. He stated that discussions with Illinois and Florida have progressed further and additional conversations have occurred with California and Colorado, as well as eight other states. He stated that the firm has been a leading contractor of portfolio dispositions for many years.

Senator Cannel remarked that regardless what is decided with regard to the State’s assets, it is a good idea to assess what there is available. He asked if there is any agency in State government that has this information. Senator Burns remarked that ten to twelve years ago he was a cochairman of an assets committee that attempted to get a handle on the assets that were owned by the State and it was a frustrating experience.

Senator Martin commented that if the State does not do something like hiring this firm, they may never know what all the assets are. He stated that he liked the ideas that were presented in Committee today.

Without objection, the meeting adjourned at 2:10 p.m.

Respectfully submitted,

Tracey Moulton
Committee Secretary

(Tapes and attachments on file in the Secretary of Senate's Office/Resource Center, Room 115.)