



What is the state real estate policy, how the Ministry of Finance and SJSC “*Valsts nekustamie īpašumi*” manage real estate

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Audit report

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The cover design includes an image from the personal archives of an auditor.



Dear Reader,

The State Audit Office of Latvia has completed performance audit on the state real estate management policy, for which the Ministry of Finance is responsible in the country, and on the activities of the Ministry of Finance and its state-owned enterprise “*Valsts nekustamie īpašumi*”. We assessed only at office buildings and premises, which are an essential basic resource for any state institution, it is a resource that affects the economy of the institution’s operation, because it is related to expenses, both current expenses and capital expenses.

This is another audit showing a lack of or insufficient cooperation among state institutions, and another audit showing a lack of complete, comparative, and aggregated data.

It is undeniable that in the course of the implementation of the concept of unified governance and management of state real estate adopted in 2006, the Ministry of Finance has not idled but has worked a lot because a series of different laws and regulations have been adopted, many real estates have been taken over by the Ministry of Finance from other institutions. SJSC “*Valsts nekustamie īpašumi*” expropriated and continues to expropriate the properties unnecessary for the state as well as developed State Real Estate Information System.

However, upon completion of the audit in February 2023, id est, 16 years after the adoption of the Concept, one must conclude that provision of state institutions with the necessary premises is not coordinated in general, state real estate and the real estate of state-owned enterprises specially established for real estate management are managed in a fragmented manner and without a vision for the future.

Fragmentation is characterized by the inconsistent structure of state property managers and providers of real estate necessary for the state whereas in

some ministries, a more or less decentralized structure of managers has been preserved, including a number of institutions that manage their own real estate. In ministries where a special institution for property management has been established, these are both institutions and state-owned enterprises. The range of public sector institutions served and services provided is inconsistent in SJSC “*Valsts nekustamie īpašumi*” as well.

During the implementation of the Concept, a unified approach to the management of state real estate was developed, but the management of state real estate owned by a state-owned enterprise (SOE) and the determination of rent is the decision of its shareholders and management bodies.

The State Audit Office of Latvia considers that the real estate of SOEs is also indirectly owned by the state. Accordingly, the state property transferred to the management of VAS “*Valsts nekustamie īpašumi*” and the property of the SOE itself must first of all serve to provide state institutions with appropriate real estate in the most effective and economical way possible. The shareholder must ensure the balancing of state interests and the profitability of the SOE’s operation.

Taking into account the close connection of SJSC “*Valsts nekustamie īpašumi*” with the Ministry of Finance, the rent of the building ensemble of the Ministry of the Interior in Čiekurkalns, Riga, by collecting which from the Provision State Agency, SJSC “*Valsts nekustamie īpašumi*” managed to earn almost two million euros annually during the four-year period audited. We understand that the SOE must compensate the unprofitable sites, but does the Ministry of Finance believe that this can be done with such a financial flow, with cross-subsidies? Shouldn’t the provision of state institutions with premises be

planned meaningfully, truthfully and according to the real situation in the budget by also reviewing the base expenses.

The Ministry of Finance is currently preparing a final impact assessment report of the Concept. We also invite it to evaluate impartially whether a SOE is the most beneficial way for the state to provide state institutions with the premises they need.

We thank the employees of the audited entities, the Ministry of Finance and SJSC "Valsts

nekustamie īpašumi" for their cooperation, provided information, explanations, and opinions during the audit. We thank the other ministries, their subordinate authorities and central authorities that participated in the survey and interviews.

Respectfully
Ms Inga Vilka
Department Director



Summary

The Republic of Latvia owns real estate worth 4.62 billion eurosⁱ. SOEs also own real estate. It should all work together for the public benefit.

The real estate owned by the state is diverse in composition such as buildings, structures, different types of land. Real estate is an important resource necessary for the implementation of state functions, including the provision of services and ensuring operations. At the same time, the state also owns properties that it does not need and that cause expenses. The state-owned buildings are also very diverse in terms of type and usage possibilities like office buildings, building for education, culture, sports, healthcare, social services, communications, warehouses, fire stations, police stations, and other buildings.

The state, as an owner, must manage its properties thoroughly and carefully, and the responsibility of the state as the owner of real estate has been transferred to the institutions of various ministries, to which the relevant property has been transferred into possession.

The Ministry of Finance is responsible for the development and implementation of state real estate management policy.

The Ministry of Finance itself has more than 550,000 square metres of the area of buildings and structures (11% of the total area of state-owned buildings and structures) and 1.4 thousand hectares of landⁱⁱ. The Ministry of Finance is the sole shareholder of State-owned Joint Stock Company "Valsts nekustamie īpašumi", which governs, manages and develops both its own real estate and the real estate owned by the state and transferred to the possession of the Ministry of Finance and certain other ministries, as well as provides state institutions with the premises required for the performance of public functions.

This audit assessed issues related to both the development and implementation of the state real estate management policy, as well as issues related to the operation of SJSC "Valsts nekustamie īpašumi" in the management and development of real estate, and certain issues regarding the management of SJSC "Valsts nekustamie īpašumi".



Real estate is a crucial resource necessary for the implementation of state functions.

Main conclusions

Planning and implementation of the state real estate management policy is fragmentary, without complete and high-quality data

In Latvia, there is no effective and purposeful state real estate management system established. The Cabinet of Ministers approved the concept of unified administration and management of state real estate in 2006 (Concept) by setting the direction towards a model of centralized (within ministries) management of state real estate and the creation of a unified, efficient and transparent mechanism for state real estate governance and management. However, deviations from the basic idea were allowed and various exceptions were made already during the development of the Concept without obtaining support from various institutions, which has led to the fact that the problems mentioned in the Concept still exist and have not been resolved 16 years after the Concept was approved. Deficiencies in the management of the tasks included in the Concept and cooperation with all institutions involved in the implementation of the Concept were also identified. The established real estate management system, which is necessary for the implementation of state functions, is fragmented because it includes both different real estate managers and different principles for determining rent and management fees, therefore it is necessary to review the existing approach to use both state budget funds for real estate maintenance and the state real estate itself more effectively.

Although the move towards a centralized (within ministries) model of state real estate management was carried out in accordance with the Concept in general, the existing model is still inconsistent, fragmented and partially centralized within ministries institutionally and as per types of property. Consequently, no confirmation has been obtained as to whether one has managed to achieve a more rational use of state budget funds and human resources.

The transition to rent fee provided for in the Concept took place partially taking into account the limited funding opportunities of the state budget, thus diverting from the transition to rent fee by reaching one of the main goals of making savings for the planned repairs and construction work. Stipulating that an owner ensures planning, implementation, and supervision of state real estate management activities taking into account the opportunities of financial resources already in the regulatory framework on the principles and procedures of state real estate management has resulted in the situation that component planned for repairs and construction work in lease contracts concluded with public institutions and included in the audit sample has been calculated and collected less for 296,700 euros between 2018 and 2021. Thus, the necessary repairs are not carried out in a timely manner and higher costs for the state budget may arise in the future.

It was also necessary to create an appropriate information system for a unified approach to govern and manage state real estate for establishing impartial prerequisites for data analysis, comparability and planning of state real estate management. Although the Ministry of Finance and SJSC "Valsts nekustamie īpašumi" have ensured the development of such an information system, the data collected

in it is not complete, high-quality and reliable, therefore carrying out a full-fledged data analysis is impossible and necessary information on the issues of state real estate governance and management is still obtained from institutions manually in the form of various surveys.

Since 2021, the country has not had a policy planning document with a future view on state real estate management because the Concept of unified state real estate governance and management was valid until the end of 2020. Therefore, the direction of the state in the field of real estate management is currently unclear. The Ministry of Finance is currently preparing a final impact report of the Concept, which will determine the tasks to be performed in the field of state real estate management policy.

Not all the activities of SJSC "Valsts nekustamie īpašumi" are beneficial for the state budget

The largest part of turnover of SJSC "Valsts nekustamie īpašumi" (about 36 million euros in 2021) consists of rental and management revenues, while the largest tenants (86%) are state institutions. More than 40% of the rental and management revenues of SJSC "Valsts nekustamie īpašumi" comes from two real estates in Riga, that is, 1 Talejas Street and 1 Čiekurkalna 1st Line K-1, which are mostly leased to public sector institutions, thus obtaining revenues from the state budget funds. The audit has found that these two real estates have the highest rent on average (over 11 euros/m²) for public institutions in the cases included in the audit sample. This is due to the fact that a significant part of the rent is made up of the borrowed capital and the own invested funds of SJSC "Valsts nekustamie īpašumi" at these addresses, and its share in the contracts is from 61% to 96 % of the rent fee.



The state institution has overpaid 1,896,801 euros per year for the rent on average.

Since the lumpsums of bank loans and interest payments included in the rent fee differ from the actual payments for the real estate located at 1 Čiekurkalna 1st Line K-1, Riga, which is leased by the Provision State Agency of the Ministry of the Interior, the Provision State Agency of the Ministry of the Interior has paid 1,896,801 euros more per year on average for component K than the actual expenses of this component between 2018 and 2021. The approach of SJSC "Valsts nekustamie īpašumi" implemented in this way, when the rent is not reviewed and reduced for state institutions according to the actual costs, is not economical for the state. Such an example does not motivate the state institutions, which manage the used state real estate themselves, to transfer them to the possession of the Ministry of Finance or to a specially established SOE and to switch to rent fee relations.

Regarding the real estate located at 1 Talejas Street, Riga, the State Audit Office of Latvia draws attention to the fact that *Biroju centrs Ezerparks* LTD was established for the construction and further management of the building on the basis of the principles of public and private partnership by borrowing financial resources of 65.6 million euros in 2008. The State Revenue Service is the largest tenant of the real estate located at 1 Talejas Street, Riga, for whose needs this real estate was also built. The State Audit Office of Latvia draws attention to the fact that the responsible institutions should evaluate various aspects of the principles of this public and private partnership and their impact on the state budget impartially to assess the necessity of establishing such a partnership in the future thoroughly.

Although the use of balanced financial indicators appropriate to the specifics of the activity of the SOE and the interests of the state should be expected from SJSC "Valsts nekustamie īpašumi" as the SOE of the Ministry of Finance, only general financial target indicators are defined in the Strategy. The proposed indicators, without segmentation and restrictions regarding public sector, do not ensure the interests of state by renting out the necessary premises to public entities in the most economical way possible, nor do they encourage changing rent fee in cases where the actual expenses have decreased.

Investment planning of SJSC "Valsts nekustamie īpašumi" is unclear and without sufficient justification in some cases

To preserve and develop the state real estate, it is necessary to invest in it. The audit has identified deficiencies in investment planning and implementation of SJSC "Valsts nekustamie īpašumi" as there is no tracking of how the real estate sites are included in investment plans; there is no sufficient justification why the sites included in the investment plans are replaced by others; and there is no sufficient management supervision over the execution of the investment plans. Therefore, it is impossible to gain confidence that capital investments are made in those real estate sites that need them the most. In addition to that, the implementation of investments in SJSC "Valsts nekustamie īpašumi" is not implemented to such an extent that SJSC "Valsts nekustamie īpašumi" achieves the goals set in the Portfolio Strategy for 2022 and 2027 regarding the improvement of the technical condition of buildings. Consequently, there is a risk that the condition of real estate will deteriorate and may create an additional burden on the state budget in the future.

However, one should draw attention to the fact at the same time that from the profit of SJSC "Valsts nekustamie īpašumi" for the years 2018, 2019 and 2020, which was directed to investments in the state real estate and SJSC "Valsts nekustamie īpašumi" in the amount of 11.8 million euros, only 18 % were used until 31 December 2021. It is not clear why channelling the funding for three years was necessary when it was found that the planned works were not being fulfilled already after the second year, thus allowing the reduction of the state budget revenues in the given year.



Only 18% of the share of SJSC "Valsts nekustamie īpašumi" profit was used, which should have been directed to real estate development.

Performance evaluation of SJSC "Valsts nekustamie īpašumi" has decreased; Board Members take up positions in other SOEs at the same time; majority of Council Members have a temporary status

The Board of SJSC "Valsts nekustamie īpašumi" is responsible for both appropriate calculation of rent fee and planning and implementation of investment projects. Simultaneously, the Council and the shareholder of SJSC "Valsts nekustamie īpašumi" play an important role in the successful operation of SJSC "Valsts nekustamie īpašumi".

The evaluation provided by the Ministry of Finance on the performance of SJSC "Valsts nekustamie īpašumi" in 2021 as satisfactory as opposed to the assessment "very good" in 2020 raises questions as to why the problems that arose in the operation of SJSC "Valsts nekustamie īpašumi" were not resolved in a timely manner.

The State Audit Office of Latvia draws attention to the fact that three of the four Council Members of SJSC "Valsts nekustamie īpašumi" were not appointed as a result of a competition, they have the status of temporary Council Members, and they also hold leading positions in state institutions.

In addition to that, Chair of the Board of SJSC "Valsts nekustamie īpašumi" performs the duties of the Chair of the Board of another SOE established by the state since 26 October 2021, while one of Board Members performed the duties of the Chair of the Board of a municipal enterprise founded by a local government from 4 July 2022 to 17 November 2022.

Taking into account the above-mentioned deficiencies in the operation of SJSC "Valsts nekustamie īpašumi", the audit failed to obtain confirmation that SJSC "Valsts nekustamie īpašumi" would manage real estate with due diligence and in the quality expected from the largest manager of Latvia's greatest assets, that is, land and buildingsⁱⁱⁱ.

State real estate management means participation and responsibility of all state institutions

Although the Ministry of Finance was responsible for the implementation of the Concept of unified state real estate governance and management, as well as the development and implementation of the state real estate management policy, the auditors consider that purposeful and effective implementation of this policy is not possible without the participation of other state institutions that own or use state real estate, as well as a consistent state position and future vision on the best course of action with all state real estate sites. The Ministry of Finance must be ensured the role of coordinating institution in the implementation of this policy. During the audited period, the activities of the Ministry of Finance, as the institution responsible for the planning and implementation of the state real estate management policy, were only partially focused on organizing the field of state real estate management.



The Ministry of Finance should coordinate the implementation of the state real estate management policy.

Considering all the above-mentioned irregularities and deficiencies, the auditors have not got confirmation that the Ministry of Finance and SJSC "Valsts nekustamie īpašumi" plan and implement targeted and effective state real estate management.

Key recommendations

Based on the audit conclusions, the Ministry of Finance, as the institution responsible for both the planning and implementation of the state real estate policy, and SJSC "*Valsts nekustamie īpašumi*" as the manager of state-owned real estate and its own real estate, have been given 11 recommendations, implementation of which shall:

- Define the state real estate management policy;
- Establish such a national real estate information system that will contain complete, high-quality, and reliable data;
- Improve the governance of state-owned capital shares in SJSC "*Valsts nekustamie īpašumi*" by monitoring the use of the channelled profit share in accordance with the set goals;
- Provide an economically justified rent fee for public entities;
- Collect rent fee from private law subjects in full and in accordance with the existing market situation;
- Ensure SJSC "*Valsts nekustamie īpašumi*" with transparent, justified, and traceable investment planning and implementation, which will contribute to the improvement and development of real estate necessary for state institutions.

References

- ⁱ Financial report of Annual Financial Statement for 2021: Balance Sheet (Central Government (Consolidated)), including the costs of developing real estate.
- ⁱⁱ Information provided by SJSC "Valsts nekustamie īpašumi" electronically on 26 April 2022 using SREIS data as of 3 January 2022.
- ⁱⁱⁱ <https://www.vni.lv/par-mums/par-uznemumu#Finances> (viewed on 9 February 2023).