

STATEMENT OF FRANK P. LAWLEY, JR., DEPUTY COUNSEL
DEPARTMENT OF THE AUDITOR GENERAL BEFORE SELECT
COMMITTEE, PURSUANT TO HOUSE RESOLUTION 98 MADE ON
JANUARY 17, 1974

I am Frank P. Lawley, Jr., Deputy Counsel to Auditor General Robert P. Casey, and I have been asked to testify today as to a special audit conducted by the Department of the Auditor General of a lease entered into on December 30, 1971, between the Commonwealth (through the Department of Property and Supplies) and a corporation named 200 North Third Inc.

The lease is for over 85,000 square feet of space here in Harrisburg, in what is now known as the Fulton Building at Third and Locust Streets, and which is more familiarly known to most of us as the former Hotel Harrisburger.

Auditor General Casey first learned of this lease early in January, 1972 from a press account announcing the existence of the lease. That is, he learned of the lease after it was signed, and became a binding obligation of the Commonwealth.

At the outset, I believe it important to remind the Committee that since the Constitutional changes in 1968, as implemented by amendments to The Fiscal Code, which were passed by the General Assembly in 1971, the Auditor General has no power, duty or responsibility to examine and approve or disapprove any proposed Commonwealth lease-- either in or out of Harrisburg. Under present law, so far as Harrisburg is concerned, the power to approve or disapprove a lease rests solely with the Secretary of the Department of Property and Supplies.

Also under present law, the Auditor General has authority to audit any transaction after its occurrence. As to leases, it is the position of the Auditor General that a transaction has occurred when the lease is signed, so as to become a binding contract. Therefore, in this instance of the Hotel Harrisburger Lease, the Auditor General ordered a special audit of the transaction shortly after he learned of it, to wit, on January 20, 1972.

From a newspaper account, and from certain preliminary research, it was determined to conduct an in-depth examination with special emphasis to be given to three main points:

1) A determination of whether Charles Adler, II, had any proprietary or other beneficial interest in the Hotel property at the time the lease was signed, and the extent, if any, of his involvement in the negotiations leading up to the consummation of the lease. At the time the lease was signed, Mr. Adler was the Deputy Secretary for State Properties of the Department of Property and Supplies. He still holds this position.

2) The location and suitability of the building to provide office space sufficient for the needs of the Department of Environmental Resources, and;

3) The cost of the lease.

As to Mr. Adler's relationship with the Hotel, from our examination we were able to determine that in September, 1969, Mr. Adler was one of four purchasers of the land upon which the Hotel building was erected. The other three purchasers were the Central Dauphin Realty Company, Robert L. Richey and Stanley D. Adler, Jr., the brother of Charles Adler, II. The purchase price was listed as \$250,000.

On April 2, 1971, Charles Adler II and Stanley D. Adler, Jr., and their respective wives, sold their interests in the property. The deed recites a consideration of \$125,000 and the property was

then owned, as tenants in common, by Central Dauphin Realty Company and Robert L. Richey, each of whom had a $\frac{1}{4}$ interest and the corporation 200 North Third, Inc., which held a $\frac{1}{2}$ interest.

Later on in 1971, the $\frac{1}{4}$ interests belonging to Central Dauphin Realty Company and Robert L. Richey were, by separate deeds, conveyed to the corporation of 200 North Third, Inc. Each deed listed the consideration as being \$62,500. It is clear from the courthouse records that at the time the lease was signed between the Commonwealth and 200 North Third, Inc., the corporation owned all interest in the property. T-39

After the existence of the lease became a matter of public knowledge, Mr. Adler, on January 27, 1972, issued a press release in which he stated that, and I quote: "Early in 1971 I was asked by the Shapp Administration to consider a deputyship in the Department of Property and Supplies and ultimately decided to accept this invitation to serve the Commonwealth of Pennsylvania". The records of the Department of the Auditor General show that Mr. Adler was appointed to his present post on April 30, 1971. T-12

We were unable to determine whether Mr. Adler decided to accept the position offered before or after April 2, 1971.

Subsequently, on April 19, 1971, Mr. Adler executed a Declaration of Trust in which he transferred to a Harrisburg bank all of his interests that could possibly involve him in any conflict of interest when he assumed his new State position. T-12

It was the conclusion of the Department of the Auditor General that the possibility of a conflict of interest was eliminated by the Deputy Secretary prior to the time that he took office.

The Auditor General found, however, that what could not be eliminated was that the Deputy Secretary or persons responsible to him would be dealing with the parties with whom the Deputy Secretary had previously concluded the sale of his interest in the Hotel in developing the lease which was finally consummated.

Since 1967, eight (8) offers to lease some or all of the space in the Harrisburger Hotel to the Commonwealth had been made. The offers were made by the various owners--or agents for the owners; some were specific offers for specific space at a specific price, and others were quite general in nature.

The records of the Department of Property and Supplies indicate that Robert L. Richey (one of the then owners) communicated an offer to lease sixteen floors of the Harrisburger Hotel to the Commonwealth on March 23, 1971. On that date, Mr. Adler was one T-7

of the record owners of the hotel. It was not until April 2, 1971 that he conveyed his interest. It also appears of record that the offer of March 23, 1971 was made in response to a telephone call from H. Scott Warrick then, the Chief of the Space and Facilities Planning Unit of the Department of Property and Supplies--which unit was then under the supervision of Mr. Adler.

Mr. Adler has acknowledged the fact that he was aware that Commonwealth was a "logical tenant". He has also stated that "at all times I have avoided any participation on the negotiation of the terms of the Commonwealth of Pennsylvania's lease involving the Harrisburger Hotel". However, the Philadelphia Inquirer, on January 16, 1972, quotes Mr. Adler as stating that "I held myself some-what aloof from these negotiations".

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The question of Mr. Adler's direct or indirect participation in negotiating this lease thus remains open.] The records of the Department of Property and Supplies indicate that he did receive copies of communications having to do with the Harrisburger Hotel lease negotiations, both from the Secretary of Property and Supplies and from the Department of Environmental Resources.

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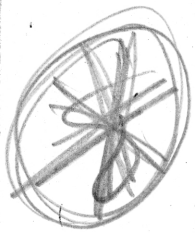
Further, an offer to lease dated October 18, 1971 which formed the basis for the actual lease, and was made by Heath Allen, Esquire, on behalf of Richey and 200 North Third Inc., was in the form of a letter from Heath Allen, Esquire, addressed to Louis I. Schwartz, then Director of the Bureau of Real Estate and Insurance, which Bureau was also under Mr. Adler's supervision in the Department of Property and Supplies. However, there are indications that Mr. Adler personally transmitted this offer to Mr. Schwartz for his "information" on October 21, 1971, with a handwritten note "new proposal".

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Under all of the circumstances, it is reasonable to assume that Mr. Adler was aware of the negotiations, and it is questionable as to whether he avoided "any" participation in the negotiations. In any event, it is clear that Mr. Adler's subordinates within the Department did participate in the negotiations--which led to the actual lease signed by the Secretary of Property and Supplies.

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In summary, as to Mr. Adler, it was the conclusion of the Department of the Auditor General that, while technically he was not in violation of the State Adverse Interest Act, his influence in this transaction was undeniable. It was subtle but unique in



that his subordinates carried on the negotiations which led to the ultimate lease. He divested himself of ownership of the hotel property after the first offer was made to the Commonwealth on March 23, 1971. He then assumed the position of supervision over the agency responsible for the negotiation of this lease, and the Commonwealth was left with no one who could deal effectively at arms' length with the owners of the hotel.

As to the location of the building and its suitability to provide office space sufficient for the needs of the Department of Environmental Resources, the Auditor General's examination developed a number of curious and yet contradictory facts:

On March 16, 1971, Mr. H. Scott Warrick, Chief of the Space and Facilities Planning Unit of the Department of Property and Supplies, reported to the Secretary of Property and Supplies and to the Governor's Office that, in order to reduce fragmentation of Executive Departments, the key "lies with the leasing of a large block of space to consolidate the Department of Environmental Resources". He also stated "Therefore, I urge that the Department of Property and Supplies be instructed to survey the lease space (approximately 135,000 square feet) and to then negotiate an option to lease for the Department of Environmental Resources".

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In an addendum to the March 16 report (dated March 22)--and this date is important--Mr. Warrick recommended the relocation of portions of the Department of Environmental Resources in the Harrisburger Hotel covering approximately 67,000 square feet.

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The date is important because the first offer to lease any portion of the Harrisburger Hotel was not made until the following day--March 23, 1971, and the lease states quite clearly that it was made in response to a phone call from Mr. Warrick. You will recall that on March 23, 1971, Mr. Adler was still an owner of record of the property.

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On March 24, Mr. Warrick reported on a meeting held with Doctor Goddard, Secretary of Environmental Resources (March 21) wherein he (Mr. Warrick) again suggested leasing the Harrisburger Hotel, this time for 84,000 square feet.

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On April 12, 1971, the Secretary of Property and Supplies reported to the Governor's Office, again stating that the Department of Environmental Resources would consolidate in leased quarters, including the Harrisburger Hotel.

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The last mentioned report is interesting because on April 22, as a member of the State Planning Board, the Secretary of Property and Supplies reported to the General State Authority that consultants (David M. Walker Associates, Inc. and Buchart Associates) be directed to complete a 20 year study of space needs which study then included a recommendation to develop a new sub-State capitol complex on Harrisburg State Hospital property, northeast of the city. The reason for the recommendation of April 22 was because the Auditor General, at a previous meeting of the General State Authority, objected to paying the consultants an additional \$126,000 on the space study which had been entered into in the previous Administration.

At the time of these various reports, it must be remembered that the Department of Environmental Resources already had three leases in the Towne House Apartment Building totalling 20,327 square feet. I will report further on those three leases shortly.

Exhibit 2

Thus, at a time when an expensive long range survey (over \$500,000) was underway, and the time when there was already a recommendation to move out of center city, a lease was entered into which Property and Supplies then knew would not fulfill the needs of the Department of Environmental Resources.

The Department of Environmental Resources estimated that the Hotel space would be utilized by 450 employes. This means that the cost is a minimum of \$1400 per year, per employe, for office space, and does not include any provision for employe or public parking.

As to the cost of the lease itself, I direct your attention to the two exhibits which I have furnished to the members of the Committee.

Exhibit No. 1, which lists the eight offers made to rent space to the Commonwealth in the Harrisburger Hotel is interesting, not only because of the dramatic increase in price per square foot per year since 1967, but also because of the relationship between such square foot price and the services to be provided by the lessor.

Note, that in August, 1971, for a total of 78,084 square feet, the cost was fixed at \$5.31 per square foot, and in September, 1971, with only the addition of the 17th and 18th floors (bringing the total square footage to 86,872), the price for the entire footage was raised to \$5.33 per square foot. In each of these offers the lessor was to supply electricity, heat and air conditioning. The last listed offer (October 18, 1971) sets forth the terms and services as they are contained in the actual lease. Additional terms are contained in the lease which are not reflected on Exhibit No. 1, but will be hereafter discussed.

Under the terms of the lease, the Commonwealth agreed to lease 86,872 square feet at \$4.78 per square foot per year (total \$415,286.00) for a basic term of ten years. The Commonwealth also obligated itself to pay for all electricity. The building was to be heated by "electric energy"; hot water was to be furnished by the installation of electric water heaters throughout the building and air conditioning was to be furnished by the utilization of electric air cooled refrigeration and an air cooled water chiller which would draw its energy from electricity.

The principal difference between the final lease and the offer made by the owners on September 15, 1971, is that under the September offer, the owner would have supplied light, heat and air conditioning at a price per square foot of \$5.33 (total \$462,956.00). Upon inquiry, on February 10, 1972, Mr. William R. Carr, Chief, Management Methods Unit of DER was asked why the change was made. He stated that the rate of \$5.33 was reduced to \$4.78 per square foot by an agreement between his Unit and the Department of Property and Supplies, which "wanted to show a price of less than \$5.00 per square foot". Mr. Carr further stated that he believed that the difference between the two figures would be sufficient to pay the cost of heating and air conditioning and regular electric bills for lighting. It is questionable whether the 55¢ per square foot difference will cover these costs but, in any event, a minimum figure of 55¢ per square foot would have to be added to the basic cost of this lease to be paid by the Commonwealth.

The lease also does not provide for three additional, but necessary, items: (1) janitorial services, (2) security personnel, and (3) parking.

As to janitorial services, the Department of Environmental Resources estimated that janitorial services would cost an additional 48¢ per square foot. As to security personnel, the DER estimated an additional cost of 30¢ per square foot per year.

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Thus, by adding the estimated costs for electricity, janitorial services and security personnel to the basic cost of \$4.78 per square foot, the cost to the taxpayers is a minimum of \$6.11 per square foot per year.

The total cost of this lease to the taxpayers per year is thus a minimum of \$530,787.92, and for the entire term the cost will be a minimum of five million three hundred seven thousand eight hundred seventy-nine dollars and twenty cents (\$5,307,879.20).

The word "minimum" has been emphasized, because even this price does not take into account the "fuel adjustment cost" for electricity previously referred to, nor does it take into account the tax escalation clause in the lease, whereby the Commonwealth agrees to pay additional rent if local taxes are raised and, finally, it does not take into account additional renovation costs which may be necessary and which, under the lease, the Commonwealth agrees to pay.

As to Exhibit No. 2, admittedly, it sets forth only selected leases for office space in the Harrisburg area. However, the selection includes the major buildings, and those which would most nearly compare with the Harrisburger Hotel. Although these leases are for over 275,000 square feet, the price in all instances did not even approach the cost of the Harrisburger Hotel Lease--either as set forth in the lease (\$4.78) or as hereinbefore computed (\$6.11).

Under the terms of the Hotel Lease, occupancy by DER was to begin in September, 1972, and full occupancy was not scheduled until April, 1973. Since the needs of DER for space were known by the present Secretary of Property and Supplies at least as early as March, 1971, it is extremely unfortunate that more consideration was not then given to seeking a solution to DER's space problems by building a State-owned office building for that Department.

One of the usual excuses given for entering into leases in Harrisburg for Commonwealth office space is that the space is needed now, and new construction involves a delay of several years.

In the present situation, two years have gone by before even a partial solution to DER's problems has been reached, and such partial solution will persist at least until 1982, the end of the ten year term of the lease.

During the course of this examination, inquiry was made as to the cost per square foot for new construction of office space in the Harrisburg area. One representative figure obtained from private sources was \$36.00 per square foot, for "fairly sophisticated" office space.

Simple arithmetic indicates that, at this price, an office building could have been constructed to house all of the Department of Environmental Resources (135,000 square feet) for \$4,860,000, and the building would belong to the taxpayers. The Harrisburger Hotel at the end of ten years will still be owned by private interests and the Commonwealth will have nothing to show for its expenditure of, at the very least, \$4,162,860.00 (\$4.78 per square foot) or more probably for its expenditure of a minimum of \$5,307,879.20 (\$6.11 per square foot) and most probably for the expenditure of even more money.

As a result of this Special Audit, the Auditor General, on May 18, 1972, reported to the Governor and stated "we recommend that immediate steps be taken to initiate a program to build an adequate State-owned office structure for the Department of Environmental Resources in Susquehanna Township on State-owned land so that this lease can be terminated at the earliest possible date".

Mr. Casey has also asked me to report to you today that as a result of the Harrisburger situation, he recommends to this Committee that legislation be passed which would reconstitute the Board of Commissioners of Public Grounds and Buildings so that the Auditor General would be replaced on that Board by a member of the General Assembly who would be of the opposite political party from the Governor, and also that the Board be required to approve all Commonwealth leases, both inside and outside of Harrisburg.

Thank you.