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FEDERAL REAL PROPERTY

Actions Needed to Address Long-standing and Complex Problems

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GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-04-119T, a testimony before the Committee on Governmental Affairs, United States Senate

Why GAO Did This Study

The federal government faces long-standing problems with excess and underutilized real property, deteriorating facilities, unreliable real property data, and costly space. These problems have multibillion-dollar cost implications and can seriously jeopardize agencies' missions. In addition, federal agencies face many challenges securing real property due to the threat of terrorism. This testimony discusses long-standing, complex problems in the federal real property area and what actions are needed to address them.

What GAO Recommends

This testimony discusses recommendations that GAO has previously made. There is a need for a comprehensive and integrated transformation strategy that could identify how to realign real property and dispose of unneeded assets; address repair and restoration needs; develop reliable data; reduce the reliance on costly leasing; and protect assets from terrorism.

An independent commission or governmentwide task force may be needed to develop this strategy, and legislative actions are needed to provide agencies with tools and incentives to help them address the problems. If resulting actions address the problems, agencies will be better able to recover asset values, reduce operating costs, improve facility conditions, enhance security, and achieve mission effectiveness.

www.gao.gov/cgi-bin/getrpt?GAO-04-119T.

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What GAO Found

Government data show that over 30 agencies control hundreds of thousands of real property assets worldwide, including facilities and land, which are worth hundreds of billions of dollars. Unfortunately, much of this vast, valuable portfolio reflects an infrastructure based on the business model and technological environment of the 1950s. Many of the assets are no longer effectively aligned with, or responsive to, agencies' changing missions and are therefore no longer needed. Further, many assets are in an alarming state of deterioration; agencies have estimated that restoration and repair needs are in the tens of billions of dollars. Compounding these problems are the lack of reliable governmentwide data for strategic asset management, a heavy reliance on costly leasing instead of ownership to meet new space needs, and the cost and challenge of protecting these assets against potential terrorism.

Given the persistence of these problems and related obstacles, we designated federal real property as a new high-risk area in January 2003. Resolving these problems will require high-level attention and effective leadership by both Congress and the administration. Also, current structures and processes may not be adequate to address the problems. Thus, as we have reported, there is a need for a comprehensive, integrated transformation strategy for real property that will focus on some of the underlying causes that contribute to these problems, such as competing stakeholder interests in real property decisions, various legal and budget-related disincentives to businesslike outcomes, inadequate capital planning, and the lack of governmentwide focus on real property issues. It is equally important that Congress and the administration work together to develop and enact needed reform legislation to give real property-holding agencies incentives and tools they need to achieve better outcomes. This would also foster a more businesslike real property environment and provide for greater accountability.

Source: VA.

A vacant VA hospital building in Milwaukee, WI

Source: PTO.

The U.S. Patent and Trademark Office (PTO) Construction Project in Alexandria, VA (February 2003)

Madam Chairman and Members of the Committee:

We welcome the opportunity to testify on the executive and legislative branch actions that are needed to address the long-standing and complex problems that led to our designation of federal real property as a high-risk area. As you know, at the start of each new Congress since 1999, we have issued a special series of reports, entitled the *Performance and Accountability Series: Major Management Challenges and Program Risks*. In January 2003, we designated federal real property a high-risk area as part of this series.[1] My testimony is based on our January 2003 high-risk report; work we have done to update information on some of the example properties from our January 2003 high-risk report; and other GAO reports on real property issues, including public-private partnerships.[2] My testimony focuses on the problems with federal real property and what needs to be done to address them.

Summary

Data from the General Services Administration (GSA) show that over 30 agencies control hundreds of thousands of real property assets worldwide, including facilities and land. According to the U.S. government's financial statements for fiscal year 2002, these assets are worth hundreds of billions of dollars. Unfortunately, much of this vast, valuable portfolio reflects an infrastructure based on the business model and technological environment of the 1950s. Many of the assets are no longer effectively aligned with, or responsive to, agencies' changing missions and are therefore no longer needed. Further, many assets are in an alarming state of deterioration; agencies estimate that restoration and repair needs are in the tens of billions of dollars. Compounding these problems are the lack of reliable governmentwide data for strategic asset management, a heavy reliance on

[1]U.S. General Accounting Office, *High-Risk Series: Federal Real Property*, GAO-03-122 (Washington, D.C.; Jan. 2003); the report on real property is a companion to GAO's 2003 high-risk update, U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: Jan. 2003); these reports are intended to help the new Congress focus its attention on the most important issues and challenges facing the federal government.

[2]Under a public-private partnership, a contractual arrangement is formed between public and private sector partners that can include a variety of activities that involve the private sector in the development, financing, ownership, and operation of a public facility or service. In the case of real property, the federal government typically would contribute the property and a private sector entity contributes financial capital and borrowing ability to redevelop or renovate the property.

costly leasing instead of ownership to meet new space needs, and the cost and challenge of protecting these assets against potential terrorism.

Resolving these long-standing problems will require high-level attention and effective leadership by both Congress and the administration. Also, because of the breadth and complexity of the issues, the long-standing nature of the problems, and the intense debate that will likely ensue, current structures and processes may not be adequate to address the problems. Thus, there is a need for a comprehensive, integrated transformation strategy for real property and an independent commission or governmentwide task force may be needed to develop the strategy. This strategy should reflect lessons learned and leading practices of public and private organizations. In addition to the strategy, it is critical that all key stakeholders—Congress, the Office of Management and Budget (OMB), and real property-holding agencies—continue to work diligently on efforts already planned and under way that are intended to promote better real property capital decisionmaking. These include assessing infrastructure and human capital needs and examining viable funding options.

If actions resulting from the transformation strategy and other efforts address the long-standing problems and are effectively implemented, agencies will be better able to recover asset values, reduce operating costs, improve facility conditions, enhance security and safety, recruit and retain employees, and achieve mission effectiveness. Realigning the government's real property, taking into consideration the future federal role and workplace needs, will be critical to improving the government's performance and ensuring accountability within expected resource limits.

The Federal Real Property Environment

The federal real property environment has many stakeholders and involves a vast and diverse portfolio of assets that are used for a wide variety of missions. Real property is generally defined as facilities; land; and anything constructed on, growing on, or attached to land. The U.S. government's fiscal year 2002 financial statements show an acquisition cost of more than $335 billion for real property assets held by the federal government on September 30, 2002.[3] In terms of facilities, the latest

[3]This value does not include stewardship assets, which are not reported on the government's balance sheet as of September 30, 2002. These assets include wilderness areas, scenic river systems, monuments, and national defense assets. Also, real property data contained in the financial statements of the U.S. government have been problematic. As discussed in more detail later, we were unable to express an opinion on the U.S. government's consolidated financial statements for fiscal year 2002.

available governmentwide data from GSA indicated that as of September 30, 2002, the federal government owned and leased approximately 3.4 billion square feet of building floor area worldwide.[4] The Department of Defense (DOD), U.S. Postal Service (USPS), GSA, and the Department of Veterans Affairs (VA) hold the majority of the owned facility space.

Federal real property managers operate in a complex and dynamic environment. Numerous laws and regulations govern the acquisition, management, and disposal of federal real property. The Federal Property and Administrative Services Act of 1949, as amended (Property Act), and the Public Buildings Act of 1959, as amended, are the laws that generally apply to real property held by federal agencies; and GSA is responsible for the acts' implementation.[5] Agencies are subject to these acts, unless they are specifically exempted from them, and some agencies may also have their own statutory authority related to real property. Agencies must also comply with numerous other laws related to real property.

The Federal Government Has Many Assets it Does Not Need

Despite significant changes in the size and mission needs of the federal government in recent years, the federal portfolio of real property assets in many ways still largely reflects the business model and technological environment of the 1950s and faces serious security challenges. In the last decade alone, the federal government has reduced its workforce by several hundred thousand personnel, and several federal agencies have had major mission changes. With these personnel reductions and mission changes, the need for existing space, including general-purpose office space, has declined overall and necessitated the need for different kinds of space. At the same time, technological advances have changed workplace needs, and many of the older buildings are not configured to accommodate new technologies. The advent of electronic government is starting to change how the public interacts with the federal government. These changes will have significant implications for the type and location of property needed in the 21st century. Furthermore, changes in the overall domestic security environment have presented an additional range of challenges to real property management that must be addressed.

[4]U.S. General Services Administration, *Federal Real Property Profile, as of September 30, 2002* (Washington, D.C.).

[5]For the Property Act, see 40 U.S.C. § 101 et. seq.; the Property Act excludes certain types of property, such as public domain assets and land reserved or dedicated for national forest or national park purposes; for the Public Buildings Act, see 40 U.S.C. § 3301 et. seq.

One reason the government has many unneeded assets is that some of the major real property-holding agencies have undergone significant mission shifts that have affected their real property needs. For example, after the Cold War, DOD's force structure was reduced by 36 percent. Despite four rounds of base closures, DOD projects that it still has considerably more property than it needs. The National Defense Authorization Act for Fiscal Year 2002,[6] which became law in December 2001, gave DOD the authority for another round of base realignments and military installation closures in 2005. Various factors may significantly reduce the need for real property held by USPS. These factors include new technologies, additional delivery options, and the opportunity for greater use of partnerships and retail co-location arrangements. A July 2003 Presidential Commission report on USPS stated, among other things, that USPS had vacant and underutilized facilities that had little, if any, value to the modern-day delivery of the nation's mail.[7] According to testimony by the Co-Chair of the Commission, rightsizing of the postal network would be crucial to USPS's transformation into a modern, 21st century institution[8].

In the mid-1990s, VA began shifting its role from being a traditional hospital-based provider of medical services to an integrated delivery system that emphasizes a full continuum of care with a significant shift from inpatient to outpatient services. Subsequently, VA has struggled to reduce its large inventory of buildings, many of which are underutilized or vacant. Although the Department of Energy (DOE) is no longer producing new nuclear weapons, it still maintains a facilities infrastructure largely designed for this purpose.

The magnitude of the problem with underutilized or excess federal property puts the government at significant risk for wasting taxpayers' money and missed opportunities. First, underutilized or excess property is costly to maintain. DOD estimates that it is spending $3 billion to $4 billion each year maintaining facilities that are not needed. In July 1999, we reported that vacant VA space was costing as much as $35 million to

[6]P.L. 107-107, 115 Stat. 1012, 1342 (2001).

[7]President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service* (Washington, D.C.: July 31, 2003).

[8]Statement of James A. Johnson, before the Senate Committee on Governmental Affairs, *U.S. Postal Service: What Can Be Done to Ensure Its Future Viability?* (Washington, D.C.: Sept. 17, 2003).

maintain each year.[9] Costs associated with excess DOE facilities, primarily for security and maintenance, exceed $70 million annually.[10] It is likely that other agencies that continue to hold excess or underutilized property are also incurring significant costs for staff time spent managing the properties and on maintenance, utilities, security, and other building needs. Second, in addition to day-to-day operational costs, holding these properties has opportunity costs for the government, because these buildings and land could be put to more cost-beneficial uses, exchanged for other needed property, or sold to generate revenue for the government. Finally, continuing to hold property that is unneeded does not present a positive image of the federal government in local communities. Instead, it presents an image of waste and inefficiency that erodes taxpayers' confidence in government. It also can have a negative impact on local economies if the property is occupying a valuable location and is not used for other purposes, sold, redeveloped, or used in a public-private partnership.

Appendix I discusses some examples of vacant, highly visible properties that are in the federal inventory— the former main VA hospital building at the Milwaukee, Wisconsin, health facility campus; St. Elizabeths Hospital in Washington, D.C.; and the former main post office building in downtown Chicago, Illinois. These examples demonstrate the range of challenges agencies face in disposing of unneeded property.

The Federal Portfolio Is in an Alarming State of Deterioration

Restoration, repair, and maintenance backlogs in federal facilities are significant and reflect the federal government's ineffective stewardship over its valuable and historic portfolio of real property assets. The state of deterioration is alarming because of the magnitude of the repair backlog— current estimates show that tens of billions of dollars will be needed to restore these assets and make them fully functional. This problem has accelerated in recent years because much of the federal portfolio was constructed over 50 years ago, and these assets are reaching the end of their useful lives. As with the problems related to underutilized or excess property, the challenges of addressing facility deterioration are also prevalent at major real property-holding agencies. For example:

[9]U.S. General Accounting Office, *VA Health Care: Challenges Facing VA in Developing an Asset Realignment Process*, GAO/T-HEHS-99-173 (Washington, D.C.: July 22, 1999).

[10]DOE Office of the Inspector General, *Disposition of the Department's Excess Facilities*, DOE/IG-0550 (Washington, D.C.: Apr. 3, 2002).

- Over the last decade, DOD reports that it has been faced with the major challenge of adequately maintaining its facilities to meet its mission requirements. Although DOD no longer reports data on backlog of repairs and maintenance, it reported in 2001 that the cost of bringing its facilities to a minimally acceptable condition was estimated at $62 billion; the cost of correcting all deficiencies was estimated at $164 billion.[11]

- The Department of the Interior (Interior) has a significant deferred maintenance backlog that the Interior Inspector General (IG) estimated in April 2002 to be as much as $8 billion to $11 billion. This backlog has affected numerous national treasures, such as Ellis Island, Yellowstone National Park, and Mount Rushmore, just to name a few.

- GSA has struggled over the years to meet the repair and alteration requirements identified at its buildings. In March 2000, we reported that GSA data showed that over half of GSA's approximately 1,700 buildings needed repairs estimated to cost about $4 billion.[12] More recently, in August 2002, we reported that this estimated backlog of identified repair and alteration needs was up to $5.7 billion.[13]

  Other agencies with repair backlogs that we highlighted in our high-risk report include the Department of State (State), DOE, the Smithsonian Institution, and USPS. Since issuing our high-risk report, we have updated our assessment of facility conditions at DOD and State.

- In February 2003, we reported that although the amount of money the active forces have spent on facility maintenance had increased recently, DOD and service officials said that these amounts had not been sufficient to halt the deterioration of facilities.[14] Too little funding to adequately maintain facilities is also aggravated by DOD's acknowledged retention of facilities in excess of its needs. Furthermore, the information that the

[11]U.S. Department of Defense, *Report to Congress: Identification of the Requirements to Reduce the Backlog of Maintenance and Repair of Defense Facilities* (Washington, D.C.: Apr. 2001).

[12]U.S. General Accounting Office, *Federal Buildings: Billions Are Needed for Repairs and Alterations*, GAO/GGD-00-98 (Washington, D.C.: Mar. 30, 2000).

[13]U.S. General Accounting Office, *Financial Condition of Federal Buildings Owned by the General Services Administration*, GAO-02-854R (Washington, D.C.: Aug. 8, 2002).

[14]U.S. General Accounting Office, *Defense Infrastructure: Changes in Funding Priorities and Strategic Planning Needed to Improve the Condition of Military Facilities*, GAO-03-274 (Washington, D.C.: Feb. 19, 2003).

services have on facility conditions is not consistent, making it difficult for Congress, DOD, and the services to direct funds to facilities where they are most needed and to accurately gauge facility conditions. And, although DOD has a strategic plan for facilities, it lacks comprehensive information on the specific actions, time frames, responsibilities, and funding needed to reach its goals. In May 2003, we also reported on a similar problem with National Guard and Reserve facilities.[15]

- In March 2003, we reported that many of the primary office buildings at overseas embassies and consulates were in poor condition.[16] In 2002, State estimated that its repair backlog was $736 million. In addition, the primary office buildings at more than half of the posts do not meet certain fire/life safety standards. State officials stated that maintenance costs would increase over time because of the age of many of the buildings, and overcrowding has become a problem at several posts.

Our work over the years has shown that the deterioration problem leads to increased operational costs, has health and safety implications that are worrisome, and can compromise agency missions. In addition, we have reported that the ultimate cost of completing delayed repairs and alterations may escalate because of inflation and increases in the severity of the problems caused by the delays.[17] As discussed above, the overall cost could also be affected by government realignment. That is, to the extent that unneeded property is also in need of repair, disposing of such property could reduce the repair backlog. Another negative effect, which is not readily apparent but nonetheless significant, is the effect that deteriorating facilities have on employee recruitment, retention, and productivity. This human capital element is troublesome because the government is often at a disadvantage in its ability to compete in the job market in terms of the salaries agencies are able to offer. Poor physical work environments exacerbate this problem and can have a negative impact on potential employees' decisions to take federal positions. Furthermore, research has shown that quality work environments make

[15]U.S. General Accounting Office, *Defense Infrastructure: Changes in Funding Priorities and Management Processes Needed to Improve Condition and Reduce Costs of Guard and Reserve Facilities*, GAO-03-516 (Washington, D.C.: May 15, 2003).

[16]U.S. General Accounting Office, *Overseas Presence: Conditions of Overseas Diplomatic Facilities*, GAO-03-557T (Washington, D.C.: Mar. 20, 2003).

[17]U.S. General Accounting Office, *Federal Buildings: Funding Repairs and Alterations Has Been a Challenge—Expanded Financing Tools Needed*, GAO-01-452 (Washington, D.C.: Apr. 12, 2001).

employees more productive and improve morale. Finally, as with excess or underutilized property, deteriorated property presents a negative image of the federal government to the public. This is particularly true when many of the assets the public uses and visits the most—such as national parks and museums—are deteriorated and in generally poor condition.

Key Decisionmakers Lack Reliable and Useful Data on Real Property Assets

Compounding the problems with excess and deteriorated property is the lack of reliable and useful real property data that are needed for strategic decisionmaking. GSA's worldwide inventory database and related reports are the only central sources of descriptive data on the makeup of the real property inventory, such as property address, square footage, acquisition date, and property type. However, in April 2002, we reported that the worldwide inventory contained data that were unreliable and of limited usefulness.[18] GSA agreed with our findings and has revamped this database and produced a new report on the federal inventory, as of September 30, 2002.[19] We have not evaluated GSA's revamped database and related report.

In addition to problems with the worldwide inventory, real property data contained in the financial statements of the U.S. government have been problematic.[20] In April 2003, we reported that—for the sixth consecutive year—we were unable to express an opinion on the U.S. government's consolidated financial statements for fiscal year 2002.[21] We have reported that because the government lacked complete and reliable information to support asset holdings—including real property—it could not satisfactorily determine that all assets were included in the financial statements, verify that certain reported assets actually existed, or substantiate the amounts at which they were valued. Aside from the

[18]U.S. General Accounting Office, *Federal Real Property: Better Governmentwide Data Needed for Strategic Decisionmaking*, GAO-02-342 (Washington, D.C.: Apr. 16, 2002).

[19]U.S. General Services Administration, *Federal Real Property Profile as of September 30, 2002* (Washington, D.C.).

[20]The Chief Financial Officers Act of 1990 (CFO Act), as expanded by the Government Management Reform Act, required the annual preparation and audit of individual financial statements for the federal government's 24 major agencies. The Department of the Treasury was also required to compile consolidated financial statements for the U.S. government annually, which we audit.

[21]U.S. General Accounting Office, *Fiscal Year 2002 U.S. Government Financial Statements: Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reform*, GAO-03-572T (Washington, D.C.: Apr. 8, 2003).

problematic financial data, some of the major real property-holding agencies—including DOD, State, GSA, and Interior—have faced challenges in developing quality management data on their real property assets. The problems at these agencies are discussed in more detail in our high-risk report.

Reliance on Costly Leasing

As a general rule, building ownership options through construction or purchase are the least expensive ways to meet agencies' long-term and recurring requirements for space. Lease-purchases—under which payments are spread out over time and ownership of the asset is eventually transferred to the government— are generally more expensive than purchase or construction but are generally less costly than using ordinary operating leases to meet long-term space needs.[22] However, over the last decade, we have reported that GSA—as the central leasing agent for most agencies—relies heavily on operating leases to meet new long-term needs because it lacks funds to pursue ownership. In 1999, we reported that for nine major operating lease acquisitions that GSA had proposed, construction would have been the least-cost option in eight cases and would have saved an estimated $126 million. Lease-purchase would have saved an estimated $107 million, compared with operating leases but would have cost $19 million more than construction.[23] A prime example of this problem was the Patent and Trademark Office's long-term requirements in northern Virginia, where the cost of meeting this need with an operating lease was estimated to be $48 million more than construction and $38 million more than lease-purchase. In August 2001, we also reported that GSA reduced the term of a proposed 20-year lease for the Department of Transportation headquarters building to 15 years so that it could meet the definition of an operating lease. GSA's fiscal year 1999 prospectus for constructing a new facility for this need showed the cost of construction was estimated to be $190 million less than an operating lease.

Operating leases have become an attractive option in part because they generally look cheaper in any given year. Pursuant to the scoring rules

[22]In an operating lease, the government makes periodic lease payments over the specified length of the lease in exchange for the use of the property.

[23]U.S. General Accounting Office, *General Services Administration: Comparison of Space Acquisition Alternatives—Leasing to Lease-Purchase and Leasing to Construction*, GAO/GGD-99-49R (Washington, D.C.: Mar. 12, 1999).

adopted as a result of the Budget Enforcement Act of 1990, the budget authority to meet the government's real property needs is to be scored—meaning recorded in the budget—in an amount equal to the government's total legal commitment. For example, for lease-purchase arrangements, the net present value of the government's legal obligations over the life of the lease contract is to be scored in the budget in the first year. For construction or purchase, the budget authority for the estimated legal obligation related to the construction costs or purchase price is to be scored in the first year. However, for many of the government's operating leases—including GSA leases, which, according to GSA, account for over 70 percent of the government's leasing expenditures and are self-insured in the event of cancellation—only the budget authority to cover the government's commitment for an annual lease payment is required to be scored in the budget.[24] Given this, although operating leases are generally more costly over time, compared with other options, they add much less to a single year's appropriation total than these other arrangements, making an operating lease a more attractive option from an annual budget perspective, particularly when funds for ownership are not available. Although the policy requirement for full "up-front funding" permits disclosure of the full costs to which the government is being committed, the budget scorekeeping rules allow costly operating leases to "look cheaper" in the short term and have encouraged an overreliance on them for satisfying long-term space needs.

Decisionmakers have struggled with this matter since the scoring rules were established and the tendency for agencies to choose operating leases instead of ownership became apparent. We have suggested the alternative of scoring all operating leases up-front on the basis of the underlying time requirement for the space so that all options are treated equally.[25] Although this could be a viable alternative, there would be implementation challenges if this were pursued, including the need to evaluate the validity of agencies' stated space requirements. Another option—which was recommended by the President's Commission to Study Capital Budgeting in 1999 and discussed by GAO—would be to allow agencies to establish

[24]According to the scoring rules (OMB *Circular A-11*, app. B), in cases where the operating lease does not have a cancellation clause or is not paid for with federal funds that are self-insuring, budget authority to cover the total costs expected over the life of the lease is to be scored in the first year of the lease.

[25]U.S. General Accounting Office, *Supporting Congressional Oversight: Budgetary Implications of Selected GAO Work for Fiscal Year 2003*, GAO-02-576 (Washington, D.C.: Apr. 26, 2002).

capital acquisition funds to pursue ownership where it is advantageous, from an economic perspective.[26] To date, none of these options have been implemented, and debate continues among decisionmakers about what should be done. Finding a solution for this problem has been difficult; however, change is needed because the current practice of relying on costly leasing to meet long-term space needs results in excessive costs to taxpayers and does not reflect a sensible or economically rational approach to capital asset management.

Security Against Terrorism Is an Overarching Concern

Terrorism is a major threat to federally owned and leased real property assets, the civil servants and military personnel who work in them, and the public who visits them. This was evidenced by the 1995 Oklahoma City bombing; the 1998 embassy bombings in Africa; the September 11, 2001, attacks on the World Trade Center and Pentagon; and the anthrax attacks in the fall of 2001. Since the Oklahoma City bombing, the federal government has spent billions of dollars on security upgrades within the country and overseas. A study of federal facilities done by the Justice Department in 1995 resulted in minimum-security standards and an evaluation of security conditions in the government's facilities. In October 1995, the President signed Executive Order 12977, which established an Interagency Security Committee (ISC) to enhance the quality and effectiveness of security in nonmilitary federal facilities.

Since the attacks on the World Trade Center and the Pentagon, the focus on security in federal buildings has been heightened considerably. Real property-holding agencies are employing such measures as searching vehicles that enter federal facilities, restricting parking, and installing concrete barricades. As the government's security efforts intensify, the government will be faced with important questions regarding the level of security needed to adequately protect federal facilities and how the security community should proceed. Furthermore, the 1995 Justice study placed an emphasis on increasing security where large numbers of personnel are located. However, a risk-based approach—which GSA is using for the federal buildings it controls—appears to be more desirable in light of this new round of threats. In September 2001, we reported that DOD uses a risk-based approach to reduce installation vulnerabilities, but this approach was applied primarily to installations with 300 or more

[26]U.S. General Accounting Office, *Accrual Budgeting: Experiences of Other Nations and Implications for the United States*, GAO/AIMD-00-57 (Washington, D.C.: Feb. 18, 2000).

personnel assigned on a daily basis.[27] We recommended that DOD improve this approach by ensuring all critical military facilities receive a periodic vulnerability assessment conducted by their higher headquarters regardless of the number of personnel assigned. DOD concurred and began taking action.

Since 1996, we have produced more than 60 reports and testimonies on the federal government's efforts to combat terrorism. Several of these reports have recommended that the federal government use risk management as an important element in developing a national strategy.[28] We have also reported extensively on the security problems and challenges at individual real property-holding agencies. Our high-risk report identifies the problems and challenges faced by State, DOD, Interior, GSA, USPS, and ISC. More recently, we testified on security conditions of overseas diplomatic facilities.[29] We found that State has done much over the last 4 years to improve physical security at overseas posts by, for example, constructing perimeter walls, anti-ram barriers, and access controls at many facilities. However, even with these improvements, most office facilities do not meet security standards. As a result, thousands of U.S. government employees may be more vulnerable to terrorist attacks. Furthermore, our work has shown that agency coordination is critical to addressing security challenges. In our February 2003 report on threats to selected agencies' critical computer and physical infrastructures, selected agencies identified challenges, including coordinating security efforts with GSA. GSA may often be responsible for protecting facilities that house these critical assets.[30] We recommended that steps be taken to complete the identification and analysis of their critical assets and their dependencies, including setting milestones, developing plans to address vulnerabilities, and monitoring progress.

[27]U.S. General Accounting Office, *Combating Terrorism: Actions Needed to Improve DOD Antiterrorism Program Implementation and Management*, GAO-01-909 (Washington, D.C.: Sept. 19, 2001).

[28]U.S. General Accounting Office, *Homeland Security: A Risk Management Approach Can Guide Preparedness Effort*, GAO-02-208T (Washington, D.C.: Oct. 31, 2001).

[29]GAO-03-557T.

[30]U.S. General Accounting Office, *Critical Infrastructure Protection: Challenges for Selected Agencies and Industry Sectors*, GAO-03-233 (Washington, D.C.: Feb. 28, 2003); the agencies reviewed were the Departments of Health and Human Services, Energy, and Commerce, and the Environmental Protection Agency.

In addition to the clear challenges agencies will continue to face in securing real property assets, the security issue has an impact on the other problems that we have discussed. To the extent that more funding will be needed to increase security, funding availability for repair and restoration, preparing excess property for disposal, and improving real property data systems may be further constrained. Furthermore, real property managers will have to dedicate significant staff time and other human capital resources to security issues and thus may have less time to manage other problems. Another broader effect is the impact that increased security will have on the public's access to government offices and other assets. Debate arose in the months after September 11, 2001, and continues to this day on the challenge of providing the proper balance between public access and security.

In November 2002, legislation was enacted establishing the Department of Homeland Security (DHS).[31] The Federal Protective Service, which was part of GSA and which was responsible for protecting federal agencies under GSA's jurisdiction, was among those agencies whose functions and personnel were transferred to DHS. Accordingly, DHS became responsible for protecting buildings, grounds, and property owned, occupied, or secured by the federal government that are under GSA's jurisdiction. In addition, the act provided DHS with authority to protect the buildings, grounds, and property of any other agency whose functions were transferred to DHS under the act. In September 2002, we reported on the implications that the creation of DHS would have on ISC. We concluded that the need to address ISC's lack of progress in fulfilling its responsibilities should be taken into account in establishing this new department.[32]

[31]P.L. 107-296; 116 Stat. 2135 (2002).

[32]U.S. General Accounting Office, *Building Security: Interagency Security Committee Has Had Limited Success in Fulfilling Its Responsibilities*, GAO-02-1004 (Washington, D.C.: Sept. 17, 2002).

Various Efforts Initiated, but Real Property Problems Persist Due to Factors that Require High-Level Attention

Although the federal government faces significant, long-standing problems in the real property area, it is important to give Congress, OMB, GSA, and the major real property-holding agencies credit for proposing several reform efforts and other initiatives in recent years. Legislative proposals in the 108th Congress (H.R. 2548 and H.R. 2573[33]) are aimed at enhancing real property management. H.R. 2548 would provide GSA with enhanced asset management tools, including the use of public-private partnerships for itself and other landholding agencies. This bill also provides incentives for better property management, such as allowing agencies to retain funds generated from the property to pay expenses associated with the property and fund other capital needs. In addition, the bill contains provisions aimed at improving real property data, establishing senior real property managers at agencies, developing asset management principles, and identifying specific conditions under which GSA can enter into real property partnerships with the private sector. H.R. 2573 would provide GSA with the authority to enter into public-private partnerships for itself and other landholding agencies. In July 2001, we reported that public-private partnership authority could be an important management tool to address problems in deteriorating federal buildings, but further study of this tool was needed.[34] Appendix II summarizes this report and discusses two examples of public-private partnership opportunities. In August 2003, we also reported on other methods agencies are using to finance federal capital in addition to public-private partnerships, such as incremental funding, real property swaps, and outleases.[35] Another initiative in the National Defense Authorization Act for fiscal year 2002 gave DOD the authority for another round of base realignment and military installation closures in 2005. DOD officials testified that these actions could result in recurring annual net savings of about $3 billion.

Despite these and other initiatives agencies have undertaken and the sincerity with which the federal real property community has embraced the need for reform, the problems have persisted and have been exacerbated by several factors that will require high-level attention from

[33]The Federal Property Asset Management Reform Act of 2003 and the Public Private Partnership Act of 2003, respectively.

[34]U.S. General Accounting Office, *Public-Private Partnerships: Pilot Program Needed to Demonstrate the Actual Benefits of Using Partnerships*, GAO-01-906 (Washington, D.C.: July 25, 2001).

[35]U.S. General Accounting Office, *Budget Issues: Alternative Approaches to Finance Federal Capital*, GAO-03-1011 (Washington, D.C.: Aug. 21, 2003).

Congress and the administration. These factors include competing stakeholder interests in real property decisions; various legal and budget-related disincentives to businesslike outcomes; the need for improved capital planning; and the lack of a strategic, governmentwide focus on federal real property issues. More specifically:

- Competing Stakeholder Interests - In addition to Congress, OMB, and the real property-holding agencies themselves, several other stakeholders also have an interest in how the federal government carries out its real property acquisition, management, and disposal practices. These include foreign and local governments; business interests in the communities where the assets are located; private sector construction and leasing firms; historic preservation organizations; various advocacy groups; and the public in general, which often views the facilities as the physical face of the federal government in local communities. As a result of competing stakeholder interests, decisions about real property often do not reflect the most cost-effective or efficient alternative that is in the interests of the agency or the government as a whole but instead reflect other priorities.

- Legal and Budgetary Disincentives - The complex legal and budgetary environment in which real property managers operate has a significant impact on real property decisionmaking and often does not lead to economically rational and businesslike outcomes. For example, we have reported that public-private partnerships might be a viable option for redeveloping obsolete federal property when they provide the best economic value for the government, compared with other options, such as federal financing through appropriations or sale of the property. However, most agencies are precluded from entering into such arrangements.[36] Resource limitations, in general, often prevent agencies from addressing real property needs from a strategic portfolio perspective. When available funds for capital investment are limited, Congress must weigh the need for new, modern facilities with the need for renovation, maintenance, and disposal of existing facilities, the latter of which often gets deferred. In the disposal area, a range of laws intended to address other objectives—such as laws related to historic preservation and environmental remediation—

[36]When agencies have additional flexibilities, we have found that they can still face impediments. For example, VA is required to use the proceeds from disposal of property for nursing home construction and DOD has lacked personnel with sufficient experience to undertake complex real estate transactions. See U.S. General Accounting Office, *VA Health Care: Improved Planning Needed for Management of Excess Real Property*, GAO-03-326 (Washington, D.C.: Jan. 29, 2003); U.S. General Accounting Office, *Defense Infrastructure: Greater Management Emphasis Needed to Increase the Services' Use of Expanded Leasing Authority*, GAO-02-475 (Washington, D.C.: June 6, 2002).

makes it challenging for agencies to dispose of unneeded property.

- Need for Improved Capital Planning - Over the years, we have reported that prudent capital planning can help agencies to make the most of limited resources, and failure to make timely and effective capital acquisitions can result in increased long-term costs. GAO, Congress, and OMB have identified the need to improve federal decisionmaking regarding capital investment. Our *Executive Guide*,[37] OMB's *Capital Programming Guide*, and its revisions to *Circular A-11* have attempted to provide guidance to agencies for making capital investment decisions. However, agencies are not required to use the guidance. Furthermore, agencies have not always developed overall goals and strategies for implementing capital investment decisions, nor has the federal government generally planned or budgeted for capital assets over the long term.

- Lack of a Strategic, Governmentwide Focus on Real Property Issues - Historically, there has not been a strategic, governmentwide focus on real property issues among decisionmakers. Although some efforts in recent years have attempted to address real property issues with some limited success, the problems have persisted and will continue to grow in magnitude unless they are adequately addressed from a governmentwide standpoint. Resolving the long-standing problems will require high-level attention and effective leadership by Congress and the administration and a governmentwide, strategic focus on real property issues. A strategic focus on real property would be rooted in having the appropriate incentives in place; ensuring transparency in the government's actions; and fostering a higher level of accountability to stakeholders, including taxpayers. Also, it is important that key stakeholders develop an effective system to measure results. Having quality data would be critical to evaluate the progress of various reforms as they evolve.

A Transformation Strategy Is Needed

The magnitude of real property-related problems and the complexity of the underlying factors that cause them to persist put the federal government at significant risk in this area. Real property problems related to unneeded property and the need for realignment, deteriorating conditions, unreliable data, costly space, and security concerns have multibillion-dollar cost implications and can seriously jeopardize mission

[37]U.S. General Accounting Office, *Executive Guide: Leading Practices in Capital Decision-Making*, GAO/AIMD-99-32 (Washington, D.C.: Dec. 1998).

accomplishment. Because of the breadth and complexity of the issues involved, the long-standing nature of the problems, and the intense debate about potential solutions that will likely ensue, current structures and processes may not be adequate to address the problems. Given this, we concluded in our high-risk report that a comprehensive and integrated transformation strategy for federal real property is needed, and an independent commission or governmentwide task force may be needed to develop this strategy. Such a strategy, based on input from agencies, the private sector, and other interested groups, could comprehensively address these long-standing problems with specific proposals on how best to

- realign the federal infrastructure and dispose of unneeded property, taking into account mission requirements, changes in technology, security needs, costs, and how the government conducts business in the 21st century;
- address the significant repair and restoration needs of the federal portfolio;
- ensure that reliable governmentwide and agency-specific real property data—both financial and program related—are available for informed decisionmaking;
- resolve the problem of heavy reliance on costly leasing; and
- consider the impact that the threat of terrorism will have on real property needs and challenges, including how to balance public access with safety.

To be effective in addressing these problems, it would be important for the strategy to focus on

- minimizing the negative effects associated with competing stakeholder interests in real property decisionmaking;
- providing agencies with appropriate tools and incentives that will facilitate businesslike decisions—for example, consideration should be given to what financing options should be available; how disposal proceeds should be handled; what process would permit comparisons between rehabilitation/renovation and replacement and among construction, purchase, lease-purchase, and operating lease; and how public-private partnerships should be evaluated;
- addressing federal human capital issues related to real property by recognizing that real property conditions affect the federal government's

ability to attract and retain high-performing individuals and the productivity and morale of employees;

- improving real property capital planning in the federal government by helping agencies to better integrate agency mission considerations into the capital decisionmaking process, make businesslike decisions when evaluating and selecting capital assets, evaluate and select capital assets by using an investment approach, evaluate results on an ongoing basis, and develop long-term capital plans; and

- ensuring credible, rational, long-term budget planning for facility sustainment, modernization, or recapitalization.

The transformation strategy should also reflect the lessons learned and leading practices of organizations in the public and private sectors that have attempted to reform their real property practices. Over the past decade, leading organizations in both the public and private sectors have been recognizing the impact that real property decisions have on their overall success. Better managing real property assets in the current environment calls for a significant departure from the traditional way of doing business. Solutions should not only correct the long-standing problems we have identified but also be responsive to and supportive of agencies' changing missions, security concerns, and technological needs in the 21st century. If actions resulting from the transformation strategy comprehensively address the problems and are effectively implemented, agencies will be better positioned to recover asset values, reduce operating costs, improve facility conditions, enhance safety and security, recruit and retain employees, and achieve mission effectiveness.

In addition to developing a transformation strategy, it is critical that all the key stakeholders in government—Congress, OMB, and real property-holding agencies—continue to work diligently on the efforts planned and already under way that are intended to promote better real property capital decisionmaking, such as enacting reform legislation, assessing infrastructure and human capital needs, and examining viable funding options. Congress and the administration could work together to develop and enact reform legislation to give real property-holding agencies the tools they need to achieve better outcomes, foster a more businesslike real property environment, and provide for greater accountability for real property stewardship. These tools could include, where appropriate, the ability to retain a portion of the proceeds from disposal and the use of public-private partnerships in cases where they represent the best economic value to the government. Congress and the administration could

also elevate the importance of real property in policy debates and recognize the impact that real property decisions have on agencies' missions. Solving the problems in this area will undeniably require a reconsideration of funding priorities at a time when budget constraints will be pervasive. However, experimenting with creative financing tools where they provide the best economic value for the government and allocating sufficient funding will likely result in long-term benefits.

Without effective incentives and tools; top management accountability, leadership, and commitment; adequate funding; full transparency with regard to the government's real property activities; and an effective system to measure results, long-standing real property problems will continue and likely worsen. However, the overall risk to the government and taxpayers could be substantially reduced if an effective transformation strategy is developed and successfully implemented, reforms are made, and property-holding agencies effectively implement current and planned initiatives. Since our high-risk report was issued, OMB has informed us that it is taking steps to address the federal government's problems in the real property area. Specifically, it has formed a team within OMB to determine how to approach the resolution of these long-standing issues. To assist OMB with its efforts, we have agreed to meet regularly to discuss progress and have provided OMB with specific suggestions on the types of actions and results that could be helpful in justifying the removal of real property from the high-risk list.

Madam Chairman, this concludes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

Contacts and Acknowledgments

For further information on this testimony, please contact Bernard L. Ungar on (202) 512-2834 or at ungarb@gao.gov. Key contributions to this testimony were made by Kevin Bailey, Christine Bonham, Casey Brown, John Brummett, Maria Edelstein, Anne Kidd, Mark Little, Susan Michal-Smith, David Sausville, and Gerald Stankosky.

Appendix I: Examples of Vacant Federal Property

Three examples of vacant, highly visible federal properties are the former main Department of Veterans Affairs (VA) hospital building in Milwaukee, Wisconsin; St. Elizabeths Hospital in Washington, D.C.; and the former main post office building in downtown Chicago, Illinois.

Former Main VA Hospital Building in Milwaukee, Wisconsin

A VA-owned building at a health care facility campus in Milwaukee, Wisconsin is an example of a long-held vacant federal property. This 134,000 square foot building, which is shown in figure 1, has been vacant for about 14 years. The building had been used as the campus's main hospital but was vacated in 1989 primarily because a new main hospital was built on the campus. VA officials told us that in June 1999, a consulting firm—Economic Research Associates—issued a study in which it identified various options for VA to consider in trying to enhance the use of various vacant and underutilized buildings on the Milwaukee campus, including the former main hospital building.[38] On the basis of the study's results, VA officials have told us that a substantial investment of capital would in all likelihood be needed to convert this building for alternate use. For example, to convert the building for use as housing for the elderly, the study estimated that about $8.4 million to $9.3 million would be needed. VA officials also mentioned that various organizations, such as the Salvation Army and the Knights of Columbus, expressed some interest in leasing the building; but thus far, VA has not received any firm offers from these organizations. VA officials told us that in fiscal year 2001, VA incurred about $348,000 in maintenance costs for this building, which included such expenses as utilities, pest management, and security. Also, the officials said that VA currently has no alternate use or disposal plans for this building. However, VA officials have told us that updated information on the planned disposal of its vacant and underutilized property would in all likelihood be available after the Secretary of Veterans Affairs approves the results of the Capital Asset Realignment for Enhanced Services process, expected after December 2003.

[38] Economic Research Associates, *Report for Enhanced-Use Options*, *Zablocki VA Medical Center*, *Milwaukee*, *Wisconsin*, *Submitted to Department of Veterans Affairs*, ERA Project Number: 12460 (Apr. 1998; Re-Issue June 1999).

Figure 1: The Former Main VA Hospital Building at the Milwaukee, Wisconsin, Health Facility Campus

Source: VA.

St. Elizabeths Hospital, Washington, D.C.

The west campus of St. Elizabeths, which has 61 mostly vacant buildings containing about 1.2 million square feet of space on 182 acres, is held by the Department of Health and Human Services (HHS). During the Civil War, the hospital was used to house soldiers recuperating from amputations, and the property contains a civil war cemetery. In 1990, the property—which contains magnificent vistas of the rivers and the city—was designated a national historic landmark. This is the same designation given to the White House, the U.S. Capitol building, and other buildings that have historic significance. HHS has not needed the property for many years. In April 2001, we reported that the property had significantly deteriorated and had environmental and historic preservation issues that would need to be addressed in order for the property to be disposed of or transferred to another federal agency.[39]

In the last year, the General Services Administration (GSA), the District of Columbia (the District), HHS, and various public interest groups have

[39]U.S. General Accounting Office, *St. Elizabeths Hospital: Real Property Issues Related to the West Campus*, GAO-01-434 (Washington, D.C.: Apr. 16, 2001).

been working to resolve the situation at St. Elizabeths. In May 2002, the Urban Land Institute formed an advisory panel that reported on several options for redeveloping the site.[40] The panel recommended that the federal government transfer the west campus to the District and that the District should identify a master developer for the site. The panel further recommended that the master developer consider redeveloping the site into four campus areas without changing the character of the surrounding neighborhoods and without displacing existing residents. The panel recommended preserving the historic buildings through adaptive use and sensitive addition of new buildings. In addition to the panel, an executive steering committee and a working group, each consisting of representatives from the District, HHS, GSA, and public interest groups, have been established and HHS and GSA have proceeded with a number of actions to prepare the property for disposal. These include preparing the property for "mothballing," which is work done to minimize further deterioration of the property while the disposal process proceeds; determining the extent of environmental remediation needed; and conducting community outreach. Figure 2 shows the vacant, boarded-up Center Building, which opened in 1855 and served as the main hospital building.

[40]Urban Land Institute, *An Advisory Services Panel Report: Saint. Elizabeths Campus, Washington, D.C.* (Washington, D.C.: May 2002).

Figure 2: The Vacant Center Building, St. Elizabeths Hospital, District of Columbia

Source: GAO.

Note: Photograph taken in January 2001.

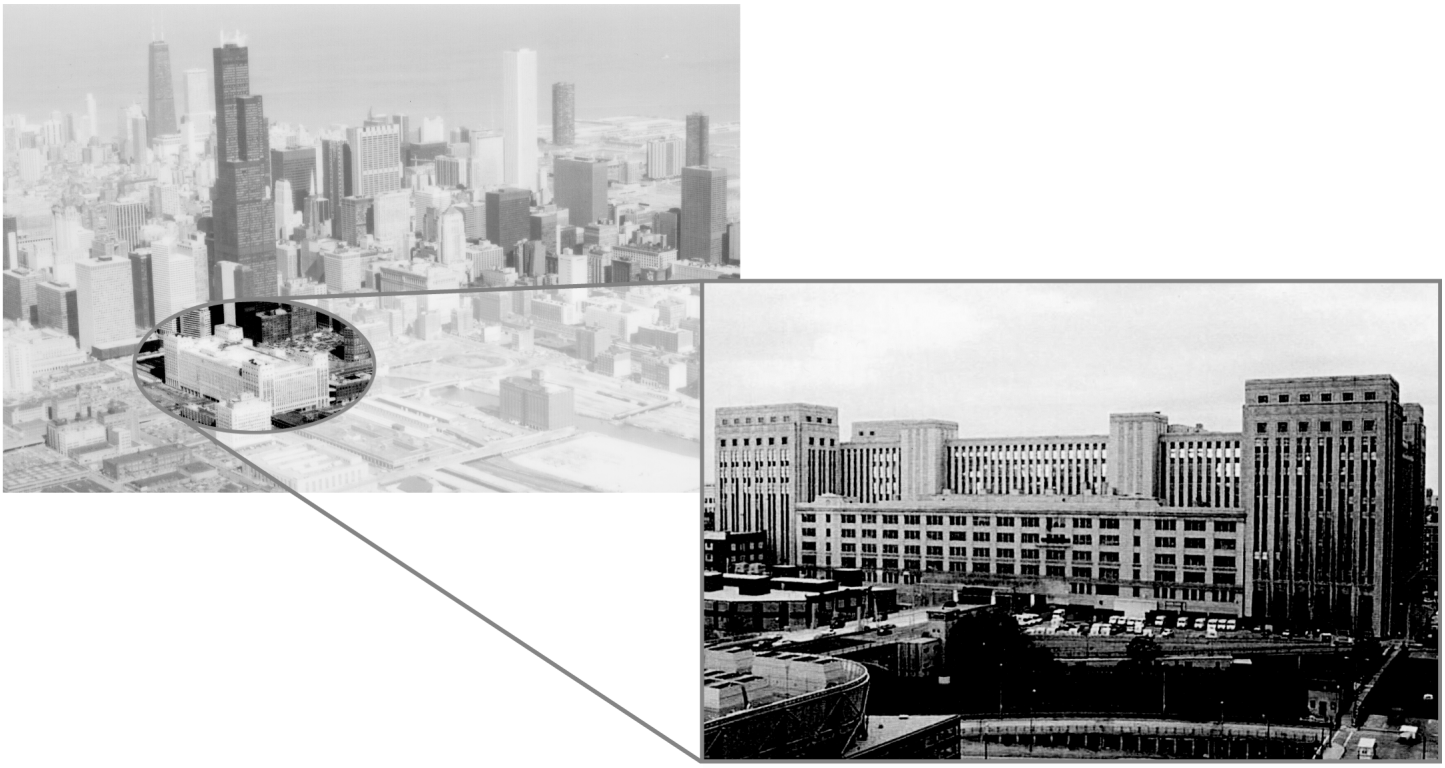
Former Chicago Main Post Office

The former Chicago main post office building is a 2.5 million square foot facility that was vacated when it was replaced with a new facility in 1997. The U.S. Postal Service (USPS) is incurring about $2 million in annual holding costs for the property. According to USPS, the property was listed for sale and publicly offered. About five offers were received and the property was placed under contract of sale for $17 million. According to USPS, completion of the sale has been delayed due to the weakness of the Chicago real estate market and the lack of an agreement between the

developer and the city of Chicago that would abate real estate taxes on a portion of the redevelopment cost for a number of years. According to USPS, this has created a "chicken and egg" situation for the developer. Potential tenants are unwilling to commit to the project unless they are sure it will go ahead. The city appears unwilling to grant the tax abatement until the users of the building are known. USPS is hopeful that the city will begin to address the issue.

In addition to the holding costs USPS is incurring, a deteriorating façade will add additional repairs costs to USPS's annual budget. Furthermore, deterioration of the system that funnels train exhaust up through eight shafts to the roof of the building is a problem that will have to be addressed. The estimated cost of repair is about $10 million and is a condition of the sale. According to USPS, another factor, which bears on the cost of redevelopment, is that the State Historic Preservation Office wants to impose requirements on the redevelopment of the building. Currently, according to USPS, these requirements will add millions of dollars to the redevelopment costs, and the buyer and USPS are reviewing them. USPS said that this project is challenging because of the large amount of space that needs to be developed. According to USPS, a breakthrough in current market conditions will have to be achieved, together with an agreement with the city, before this project can move forward. Figure 3 shows downtown Chicago with the vacant post office building highlighted.

Figure 3: The Former Main Post Office in Downtown Chicago, Illinois



Source: USPS.

Appendix II: Use of Public-Private Partnerships to Redevelop Federal Property

Under a public-private partnership, a contractual arrangement is formed between public and private sector partners that can include a variety of activities that involve the private sector in the development, financing, ownership, and operation of a public facility or service. In the case of real property, the federal government typically would contribute the property and a private sector entity contributes financial capital and borrowing ability to redevelop or renovate the property. Public-private partnerships can be a viable option for redeveloping obsolete federal property if they provide the best economic value for the government, compared with other options, such as federal financing through appropriations or sale of the property. However, most agencies are precluded from entering into such arrangements. The Department of Defense (DOD), Department of Veterans Affairs (VA), and U.S. Postal Service (USPS), however, have this authority. Proposed real property reform legislation in the 108th Congress (H.R. 2548 and H.R. 2573[41]) is aimed at enhancing real property management. H.R. 2548 would provide GSA with enhanced asset management tools, including the use of public-private partnerships for itself and other landholding agencies. This bill also provides incentives for better property management, such as allowing agencies to retain funds generated through the use of the management tools to pay expenses associated with the property and fund other capital needs. H.R. 2573 would provide GSA with the authority to enter into public-private partnerships for itself and other landholding agencies.

Public-private partnerships need to be carefully evaluated to determine whether they offer the best economic value for the government, compared with other available options. In July 2001,[42] we reported that 8 of 10 GSA properties were strong to moderate candidates for a partnership because there were potential benefits for both the private sector and the government. The potential internal rates of return (IRR)[43] for the private partner ranged from 13.7 to 17.7 percent. It should be noted that we did not calculate the IRR for the government if the government had financed the entire project. This comparison would need to be made to determine which financing option offers the best economic value for the government.

[41]The Federal Property Asset Management Reform Act of 2003 and the Public Private Partnership Act of 2003, respectively.

[42]GAO-01-906.

[43]IRR is the present value interest rate received for an investment consisting of payments and income that occur at regular periods; IRR measures the return, expressed as an interest rate, that an investor would earn on an investment.

Furthermore, public-private partnerships will not necessarily work or be the best option available to address the problems in all federal properties. Two examples of properties that were strong candidates for a partnership were the Internal Revenue Service (IRS) Service Center in Andover, Massachusetts and an office building in Portland, Oregon that houses the Immigration and Naturalization Service known as the 511 Building. Since we profiled these properties in 2001, GSA officials said that they have been unable to pursue public-private partnerships for these properties because GSA continues to lack authority to enter into such arrangements. In August 2003, we also reported on other methods agencies are using to finance federal capital in addition to public-private partnerships, such as incremental funding, real property swaps, and outleases.[44]

IRS Service Center, Andover, Massachusetts

The Andover Service Center was a strong candidate for a partnership in terms of strong federal demand, moderate private sector interest in development, and strong nonfederal demand for use of the property. The property is a 375,000 square foot, single-story, highly secured building on 37 acres that is in need of capital repairs. At the time of our review, IRS was leasing about 336,000 square feet in additional space in the area. GSA and IRS would like to consolidate IRS's operations, and the property would be desirable for the city of Andover and local developers to develop. The redevelopment strategy involved a partnership to develop a small office park consisting of six, 5-acre pads. Under this plan, the project could progress as follows:

- Year 1: Build a new 4-story, 700,000 square foot IRS facility and parking structure for current and expiring IRS leases; the complex would be at the rear of the site to allow for security and a phased development of the rest of the site.
- Year 2: IRS moves into the new facility and the old building is demolished; the partnership constructs another 250,000 square foot federal office building for non-IRS expiring leases.
- Years 3 and 4: Partnership constructs two more 250,000 square foot federal office buildings for compatible agency and private sector occupancy.

The analysis of this strategy projected a 14.4 percent lifetime IRR for the private partner and a 9.4 percent lifetime IRR for the government. Figure 4 is an aerial view of the IRS Service Center in Andover, Massachusetts.

[44]U.S. General Accounting Office, *Budget Issues: Alternative Approaches to Finance Federal Capital*, GAO-03-1011 (Washington, D.C.: Aug. 21, 2003).

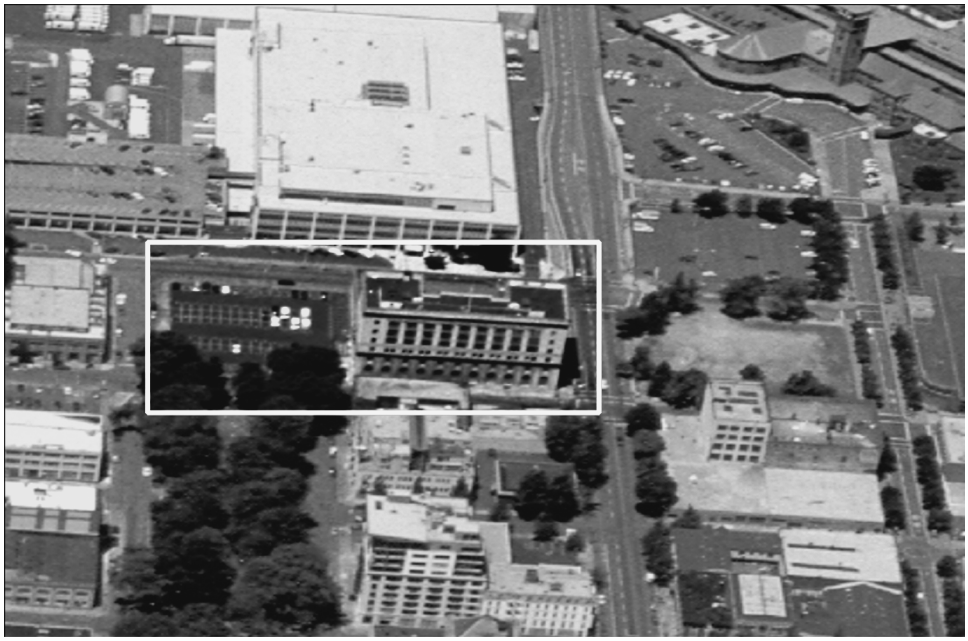
Figure 4: IRS Service Center, Andover, Massachusetts

Source: Ernst and Young.

Portland, Oregon, 511 Building

The 511 building was also a strong candidate for a partnership in terms of strong federal demand, strong private sector interest in development, and moderate nonfederal demand for use of the property. The 511 building is an historic, 6-floor building in a desirable location between downtown Portland and the trendy "Pearl District" that housed offices of the Immigration and Naturalization Service. The property includes a parking lot that was sought by the city for a pedestrian mall. The redevelopment strategy included renovating the existing historic office building to include storage use in the basement and retail or restaurant on the first floor. In addition, the strategy included acquiring an additional site for construction of a 240,000 square foot, federal office building across the street. This strategy projected a 15.7 percent lifetime IRR for the private partner and a 12.7 percent lifetime IRR for the government. Figure 5 shows the 511 building (building in center of the picture).

Figure 5: 511 Building, Portland, Oregon



Source: Ernst and Young.

If the federal government were to completely finance the Andover and Portland projects, it would not have to share returns with a private sector partner. However, we did not determine what the returns would be in such a situation and how the returns would compare with the returns under a partnership arrangement.

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