United States General Accounting Office

GAO

Report to Congressional Requesters

July 2001

PUBLIC-PRIVATE PARTNERSHIPS

Pilot Program Needed to Demonstrate the Actual Benefits of Using Partnerships

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GAO-01-906

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United States General Accounting Office
Washington, DC 20548

July 25, 2001

The Honorable Tom Davis
The Honorable John Duncan
The Honorable Stephen Horn
The Honorable Pete Sessions
The Honorable Jim Turner
House of Representatives

As stated in your October 18, 2000, request letter, each year the federal government spends billions of dollars on maintaining its buildings, yet the General Services Administration (GSA) has identified a multiyear need for $4 billion, over and above these expenditures, to maintain its existing inventory. To assist you in reviewing your legislative options in this area, you asked us to identify the potential benefits to the federal government of entering into public-private partnerships on real property, in which the federal government contributes real property and a private entity contributes financial capital and borrowing ability to redevelop or renovate the real property. We also note some buildings that are in need of action by GSA regardless of the applicability or availability of public-private partnerships.

On May 7, 2001, we briefed your offices on the results of our work. Subsequent to this briefing, your offices asked that we also transmit the results of our work to you in a report. This report summarizes the results of our work. Appendix I contains the slides used to brief your offices, including detailed information on the specific properties that were part of our study. A glossary of terms that are used in this report begins on page 48.

To identify the potential benefits of allowing federal agencies to enter into public-private partnerships, we contracted with Ernst & Young LLP, who, together with a subcontractor, Signet Partners, developed and analyzed hypothetical partnership scenarios for seven selected GSA buildings. These hypothetical partnership scenarios were developed especially for this assignment and are based on information that was made readily available by representatives of local real estate markets, city governments, and GSA. GSA had previously contracted with AEW Capital Management, L.P. (AEW) for a public-private partnership financial viability study for three properties in Washington, D.C. We contracted with AEW to update its work and included these three properties in our study. The properties included in our study were judgmentally selected to include properties

that were diverse (1) geographically, (2) in type and size, and (3) in historical features. Any actual partnerships involving these properties may be very different from these hypothetical partnership scenarios. In-depth feasibility studies would have to be done to evaluate partnership opportunities before they are undertaken.

This study only looked at the potential benefits to the federal government and private sector of public-private partnerships as one management tool to address problems in deteriorating federal buildings. We did not evaluate the potential benefits of other management tools or methods of financing that may be available for this purpose, such as federal financing through appropriations or sales or exchanges of property. Ultimately, all available alternatives would need to be evaluated to determine which could provide the best economic value for the government.

Results in Brief

Public-private partnership authority could be an important management tool to address problems in deteriorating federal buildings, but further study of how the tool would actually work and its benefits compared to other options is needed. Eight of the 10 GSA properties in our study were strong to moderate candidates for a partnership because there are potential benefits for both the private sector and the government. The potential internal rates of return (IRR) for the private partner ranged from 13.7 to 17.7 percent. Potential net benefits to the federal government of entering into these public-private partnerships include improved space, lower operating costs, and increased revenue without up-front federal capital expenditures if further analysis shows that they would not be treated as capital leases for budget-scoring purposes. However, public-private partnerships will not necessarily work or may not be the best option available to address the problems in all federal properties. Ultimately, public-private partnerships and all other alternatives would need to be carefully evaluated to determine which option offers the best economic value for the government. Two of the GSA properties in our study did not appear viable for partnerships primarily due to a lack of nonfederal demand for space and low financial return potential. Furthermore, depending on how the Office of Management and Budget (OMB) scores the transactions, some of the scenarios in our study could require up- front funding as capital leases due to the long-term need for space.

The potential benefits of public-private partnerships do not diminish the need for GSA to pursue other alternatives for addressing problems in deteriorating federal buildings. In our study, 6 of the 10 buildings had or

were at risk of having a negative net cash flow. The problems in these buildings need to be addressed regardless of the availability or applicability of public-private partnerships.

We are recommending that GSA use all available strategies to address problems in federal buildings and further explore the benefits of public-private partnerships. We are also suggesting that the Congress consider providing the Administrator of GSA with the authority to proceed with a pilot program to demonstrate the actual benefits that may be achieved. As we stated in April 2001, Congress should also consider allowing agencies to retain the funds from real property transactions.[1] If such authority is granted, Congress should continue its appropriation control and oversight over the use of any funds retained by agencies. GSA concurred with our findings and recommendations.

Background

The U.S. government is one of the world's largest property owners, with a real estate portfolio of over 400,000 defense and civilian buildings and over one-half billion acres of land. As we and others have previously reported, federal asset managers are confronted with numerous challenges in managing this multibillion-dollar real estate portfolio, including a large deferred maintenance backlog and obsolete and underutilized properties. These challenges must be addressed in an environment marked by budgetary constraints and growing demands to improve service. In response to this backlog and limited funding for repair and alteration requirements, we have suggested that the Congress consider providing the Administrator of GSA with the authority to experiment with funding alternatives, including public-private partnerships, when they reflect the best economic value available for the federal government.

The Congress has already enacted legislation that provides certain agencies with a statutory basis to enter into partnerships. This additional property management tool has been provided to the Department of Veterans Affairs and the Department of Defense. In an effort to provide more agencies with a broader range of property management tools, two bills were introduced, but were not passed, in the 106th Congress that addressed issues of federal property management. The Federal Property Asset Management Reform Act of 2000, S. 2805, would have amended the

[1] *Federal Buildings: Funding Repairs and Alterations Has Been a Challenge—Expanded Financing Tools Needed* (GAO-01-452, Apr. 12, 2001).

Federal Property and Administrative Services Act of 1949 to enhance governmentwide property management. Among other provisions, the act would have allowed federal agencies to out-lease underutilized portions of federal real property for 20 to 35 years and retain the proceeds from the transfer or disposition of real property. The Federal Asset Management Improvement Act of 1999, H.R. 3285, provided for the use of (1) partnerships with the private sector to improve and redevelop federal real property, (2) performance measures for federal property management, and (3) proceeds from these partnerships being retained for the improvement of federal real property. Neither of these bills was passed, but their provisions reflect the kinds of actions that could be taken to address the issues surrounding the management of federal real property.

Public-Private Partnerships Could Provide Important Benefits to GSA

The hypothetical public-private partnerships our contractors developed and analyzed for 10 specific GSA properties indicated that partnerships could be a viable management tool. However, more detailed feasibility studies would need to be done before partnerships are undertaken. In addition, we did not compare the benefits of public-private partnerships with other alternatives for addressing problems in federal buildings, such as appropriations for renovations. Such an analysis of all alternatives would need to be performed so that the alternative offering the best economic value for the government could be chosen. OMB staff indicated that where there is a long-term need for the property by the federal government, it is doubtful that a public-private partnership would be more economical than directly appropriating funds for renovation.

Public-private partnerships can take on many different forms. The potential benefits of any partnership would be largely defined as the partnership is being formed. The various aspects of the partnership arrangement would be negotiated and agreed upon, such as the terms of the master ground lease, which is the mechanism the federal government would use to lease its property to the partnership, and the redevelopment strategy. Both the private sector and government would share in the distribution of cash flows generated by the property.

The hypothetical partnership scenarios developed by our contractors for this study entailed some basic assumptions about the structure of the partnerships but did not detail the specifics of each partnership. For example, the hypothetical partnership scenarios did not guarantee government occupancy of the properties. However, depending on how OMB scores these transactions, some of the scenarios could trigger capital lease-scoring requirements due to the implicit long-term federal need for

the space. These issues will need to be further explored before public-private partnerships are created.

The redevelopment strategies developed for each property ranged from repairing and modernizing the existing building to demolishing the existing building and increasing the amount of office space by rebuilding multiple buildings on the same site. According to our consultants, the analysis of the partnerships for many of these properties showed a sufficient potential financial return to attract private sector interest in a partnership arrangement. Multiple potential benefits to the federal government of public-private partnerships were also identified. These potential benefits include the

- utilization of the untapped value of real property,
- conversion of buildings that are currently a net cost to GSA into net revenue producers,
- attainment of efficient and repaired federal space,
- reduction of costs incurred in functionally inefficient buildings,
- protection of public interests in historic properties, and
- creation of financial returns for the government.

When deciding whether to enter into a partnership, the government will need to weigh the expected financial return and other potential benefits against the expected costs, including potential tax consequences, associated with the partnership. Any cost associated with vacating buildings for the renovation work to be done would also have to be considered in any alternative that is evaluated.

For a public-private partnership to be a viable option, there must be interest from the private sector in partnering with the government on a selected property. The potential private sector partner's return from the partnership is a critical factor in its decision on whether to partner with the federal government. According to our contractors, about a 15-percent IRR would likely elicit strong interest from the private sector in a partnership. However, this is only one factor, and the circumstances and conditions of each partnership are unique and would have to be evaluated on a case-by-case basis by both the private sector and the federal government. For example, a somewhat lower IRR could be attractive if other conditions, such as the risk level, are favorable. In addition, when our contractors discussed possible partnership scenarios with local developers, the developers said that to participate, they would want at least a 50-year master ground lease. The slides in appendix I, containing detailed information on the properties, show that the longer lease period

would allow for the private sector to maximize its financial return from the partnership.

Our contractors determined that 8 of the 10 GSA properties in our study were strong to moderate candidates for public-private partnerships. This determination was based on the (1) estimated IRR for the private sector partner in year 10 of the project, which ranged from 13.7 to 17.7 percent; (2) level of federal demand for the space; and (3) level of nonfederal demand for space. The level of demand for space, both federal and nonfederal, affects the level of risk that the space will be vacant and thus non-income-producing. The stronger the local market is for rental space, the more likely the space will be rented and thus be income-producing for the partnership. The properties that were strong candidates for partnerships were located in areas with a strong federal and nonfederal demand for space; and many had untapped value that the partnership could utilize, such as excess land on which a new or expanded building could be built.

Public-private partnerships were not viable for 2 of the 10 GSA properties in our study. This was primarily due to a weak nonfederal demand for space and low financial potential. These properties had estimated potential IRRs of 12.4 and 10.3 percent. In addition to the relatively low IRRs, neither property had the potential of increasing the amount of rentable space available to increase the earning potential of the property, and both were in markets that had vacant office space with little or no demand for new office space.

Many factors can affect the viability of a partnership arrangement. In addition to the local federal and nonfederal demand for space, the actual cost of redevelopment of a property to meet federal needs can greatly affect the viability of a partnership arrangement. The higher the cost of renovation, the longer it will take the partnership to recoup its costs and make a profit, thus affecting the appeal of the partnership to the private sector.

In GSA's inventory, numerous buildings either have or are at risk of having a negative net cash flow due to their deteriorating condition. Four of the 10 buildings in our study are either vacant or were expected to be vacant by 2002, with little prospect of recruiting other agencies to fill the space because of the condition of the buildings. In addition, two of the other six buildings we studied were at risk of losing their current tenants because of the condition of the buildings.

If public-private partnership authority becomes available, decisionmakers and policymakers will need to consider such issues as budget score-keeping rules, the type of facilities that would be appropriate for a partnership arrangement, and congressional review and oversight. In addition, each property is unique and will thus have unique issues that will need to be negotiated and addressed as the partnership is formed. Great care will need to be taken in structuring partnerships to protect the interests of both the federal government and the private sector. Our study designed a conceptual framework for public-private partnerships in order to identify potential benefits of these partnerships. Our study did not identify or address all the issues of partnerships that will need to be considered by the decisionmakers and policymakers as partnerships are developed.

Conclusion

Action is needed to fix buildings that are in disrepair and have a negative net cash flow due to their deteriorating condition. As a result of the analysis done by our contractors, it appears that allowing GSA and other property-holding agencies to enter into public-private partnerships may enable them to deal with some of their deteriorating buildings. Partnerships could even provide other financial benefits to the federal government, such as reduced operating expenses and increased income that could be used for renovating other federal buildings. The potential benefits of public-private partnerships do not diminish the need for GSA to pursue and consider other alternatives for addressing problems in deteriorating federal buildings, such as federal financing through appropriations or the sale or exchange of property. Regardless of whether public-private partnership authority is provided, the problems with these buildings need to be addressed.

Recommendation for Executive Action

We recommend that the Administrator of GSA use all available strategies to address the problems of buildings in GSA's inventory that have or are at risk of having a negative cash flow as a result of their deteriorating condition. We also recommend that the Administrator of GSA seek statutory authority to establish a pilot program that would demonstrate the actual benefits that may be achieved from public-private partnerships that achieve the best economic value for the government.

Matters for Congressional Consideration

The Congress should consider providing the Administrator of GSA with the authority to proceed with a pilot program to demonstrate the actual benefits that may be achieved using public-private partnerships that achieve the best economic value for the government as a real property management tool. If such authority is granted, the Congress should consider allowing GSA to enter into master ground leases of sufficient length to attract private sector interest in participating in partnerships with the federal government. Our study found that a 50-year master ground lease was generally sufficient to attract private sector interest. As we stated in April 2001, Congress should also consider allowing agencies to retain the funds from real property transactions. If such authority is granted, Congress should continue its appropriation control and oversight over the use of any funds retained by agencies.

Agency Comments

On June 28, 2001, we received written comments on this report from GSA's Commissioner for the Public Buildings Service. He agreed with the findings and recommendations in our report and noted a range of property management tools that GSA is currently using to address the physical conditions of its real property inventory. These comments are reprinted in appendix II. GSA officials also provided technical comments, which have been incorporated as appropriate.

Methodology

As suggested in your request letter and discussed with your offices, we hired contractors to develop and analyze hypothetical partnership scenarios for 10 selected GSA buildings to identify the potential benefits to the federal government and private sector of allowing federal agencies to enter into public-private partnerships. GSA's National Capital Region had previously contracted for a study to analyze the financial viability of public-private partnership ventures for three buildings in Washington, D.C. As agreed with your offices, because the majority of the work for these properties had already been done, we had the contractor update its work on these 3 buildings and selected them as 3 of the 10 GSA properties.

To help us select the other 7 properties for our study, GSA provided a list of 36 properties that it considered good candidates for public-private partnerships. In preparing this list of properties, GSA officials said that they considered factors such as the strength of the real estate market in each area, the extent to which the property was currently utilized or had land that could be utilized, and the likelihood of receiving appropriations to rehabilitate the property in the near future. We judgmentally selected seven properties from this list to include properties (1) from different

geographic areas of the country, (2) of different types and sizes, and (3) with historic and nonhistoric features.

To analyze the potential viability of public-private partnerships for each of the 10 selected GSA properties, the contractors did the following:

- analyzed the local real estate markets,
- created a hypothetical partnership scenario and redevelopment plan, and
- constructed a cash flow model.

In the contractor's judgement, the partnership scenarios were structured to meet current budget-scoring rules and provisions in H.R. 3285. These provisions included the requirements that the

- property must be available for lease in whole, or in part, by federal executive agencies;
- agreements do not guarantee occupancy by the federal government;
- government will not be liable for any actions, debts, or liabilities of any person under an agreement; and
- leasehold interests of the federal government are senior to those of any lender of the nongovernmental partner.

However, a determination on how the partnerships would be treated for budget-scoring purposes would have to be made after more details are available on the partnerships.

We accompanied the contractor on the visits to the seven GSA properties that had not been previously studied. We interviewed or participated in discussions with developers and local officials in the areas where the properties were located and officials from GSA. We reviewed the contractors' work on the 10 properties for reasonableness but did not verify the data used by the contractors.

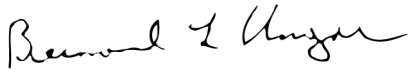
The partnership viability scenarios developed for this assignment are hypothetical, based on information that was made readily available by representatives of the local real estate markets, city governments, and GSA. Any actual partnerships involving these properties may be very different from these scenarios. In-depth feasibility studies must be done to evaluate partnership opportunities before they are pursued. There may be other benefits and costs that would need to be considered, such as the possible federal tax consequences and the costs of vacating property during renovation in some cases.

This study only looked at the potential benefits to the federal government and private sector of public-private partnerships as a management tool to address problems in deteriorating federal buildings. We did not evaluate the potential benefits of other management tools that may be available for this purpose. We did, however, discuss the implications of using public-private partnerships with OMB representatives.

We did our work between November 2000 and June 2001 in accordance with generally accepted government auditing standards.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter. We will then send copies to the Chairmen and Ranking Minority Members of Committees with jurisdiction over GSA, the Director of OMB, and the Administrator of GSA. We will make copies available to others upon request.

Major contributors to this report include Ron King, Maria Edelstein, and Lisa Wright-Solomon. If you or your staff have any questions, please contact me or Ron King on (202) 512-8387 or at ungarb@gao.gov or kingr@gao.gov.



Bernard L. Ungar
Director, Physical Infrastructure Issues

Appendix 1: Potential Benefits of Public-Private Partnerships

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Briefing Contents

- Objectives
- Methodology
- Results in Brief
- Public-Private Partnerships
- Appendix I: GSA Properties Analyzed

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Objectives

Identify the potential benefits to the federal government of entering into public-private partnerships

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Methodology

- Interviewed officials from the General Services Administration (GSA), VA, and DOD
- Employed a consultant to analyze the potential viability of public-private partnerships for seven selected GSA properties. The analysis included
  - local real estate markets
  - creation of redevelopment strategies, and
  - economic feasibility of public-private partnerships
- Employed GSA consultant to update its previous public-private partnership viability study on three GSA properties

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Methodology (con't)

- Reviewed the consultant's work for reasonableness but did not verify the data used by the consultants
- Did not evaluate the potential benefits of other management tools or methods of financing

The partnership viability scenarios developed for this assignment are hypothetical based on information readily available from people in the local real estate markets, city officials, and GSA. Any actual partnerships involving these properties may be very different from these scenarios. In-depth feasibility studies must be done to evaluate the partnership opportunities before they are undertaken.

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Results in Brief

- Public-private partnership authority is worth exploring as a potentially beneficial property management tool
  - Eight of the 10 GSA properties are strong to moderate candidates for a partnership with potential internal rates of return (IRR) for the private partner ranging from 13.7 to 17.7 percent
  - Two of the GSA properties did not appear viable for a partnership largely due to a lack of nonfederal demand for space and financial potential
  - Net benefits to the government are improved space, lower operating costs, and increased revenue, possibly without federal capital expenditures

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Results in Brief (cont'd)

- Ground lease of 50+ years may be necessary to attract private sector interest
- Action needed to stop or prevent the loss of revenue

- GSA needs to further explore the financial feasibility of entering into public-private partnerships and seek authority to enter into partnerships as a pilot program to demonstrate the actual benefits that may be achieved. For those properties that are determined not to be viable for a partnership, GSA should quickly identify alternative strategies for those buildings.

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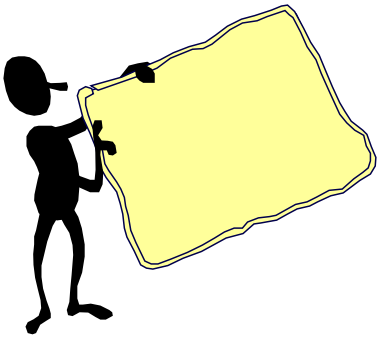
Conditions Governing a Public-Private Partnership

- Property must be available for use in whole, or in part, by federal executive agencies
- Agreements do not guarantee occupancy by the US
- Government will not be liable for any actions, debts, or liabilities of any person under an agreement
- Leasehold interests of the US are senior to any lender of the nongovernmental partner



Note: These conditions are based on legislation that was introduced during the 106th Congress, H.R. 3285

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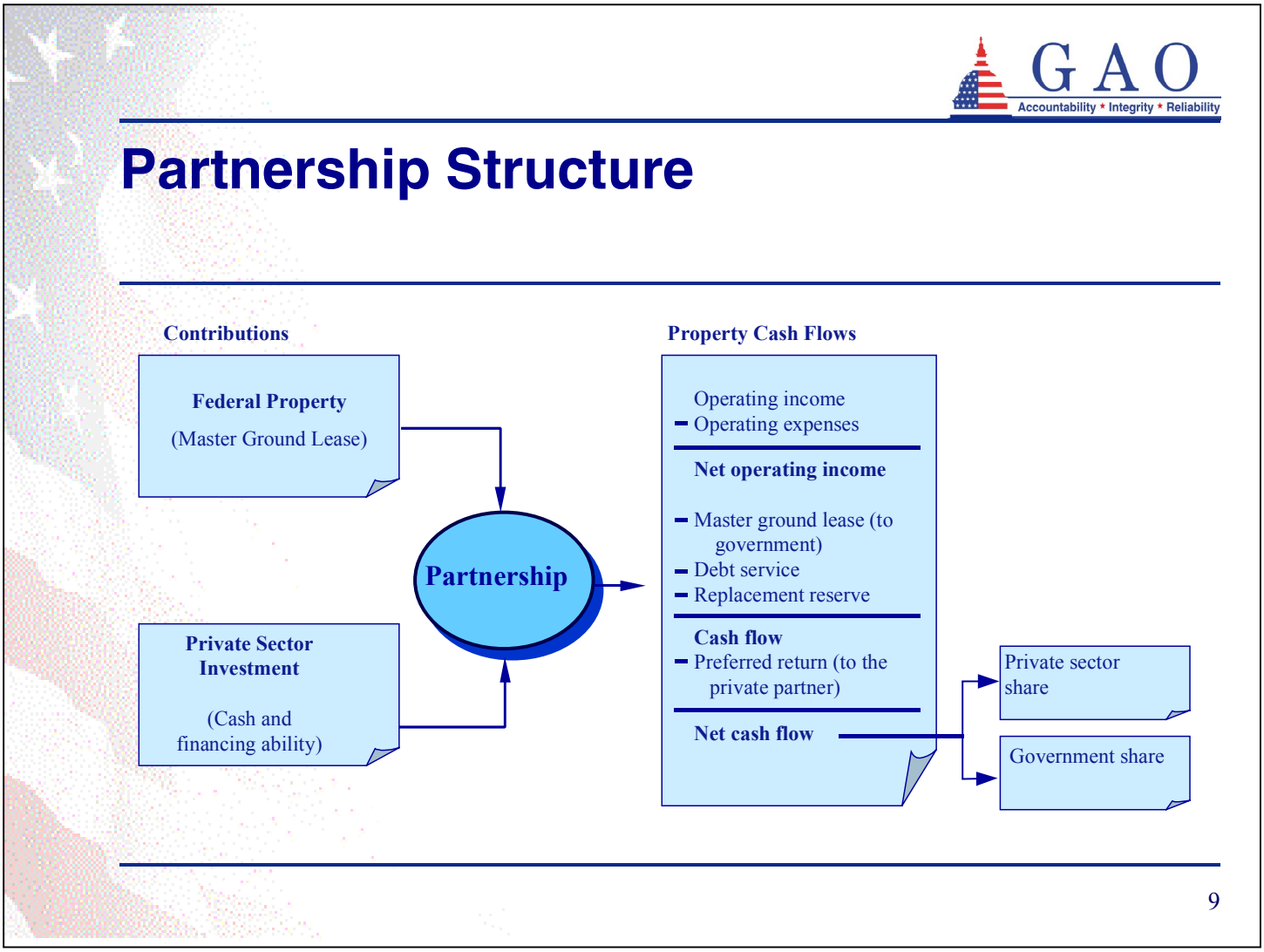
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Partnership Structure
Contributions
Federal Property
(Master Ground Lease)
Private Sector Investment
(Cash and financing ability)
Partnership
Property Cash Flows
Operating income
- Operating expenses
Net operating income
- Master ground lease (to government)
- Debt service
- Replacement reserve
Cash flow
- Preferred return (to the private partner)
Net cash flow
Private sector share
Government share
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Federal Public-Private Partnerships

Success Factors

- Federal need for property
- Real estate market demand for property
- Ability to attract and utilize private sector resources and expertise
  - Sufficient return to developer
  - Length of the master lease is sufficient
- Untapped value in underperforming assets
- Conforms with budgetary scoring rules

Constraints

- Limited federal demand for property
- High cost of remediation or renovation to meet federal needs
- Low market appeal – resulting in diminished investor interest
- Federal budget scoring and legislation do not provide for credit enhancement or lease guarantees, possibly lessening the potential IRR

Source: Ernst & Young/Signet Partners

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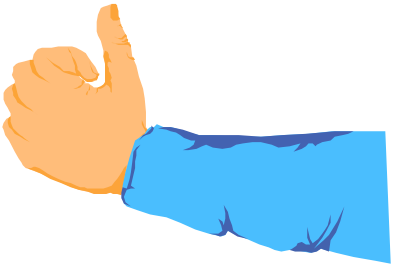
Potential Benefits to Government of Public-Private Partnerships

- Utilizes untapped value of real estate
- Turns buildings which are currently a net cost to GSA into net income producers
- Achieves efficient and repaired federal space, possibly without direct federal expenditure
- Avoids on-going expenditures in functionally inefficient buildings
- Protects public interest in historic properties
- Creates financial return for the government



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Types of Redevelopment Strategies Analyzed for GSA Properties

- Repair and modernization (FOB 8, Minneapolis, Jacksonville, Columbia)
- Demolition of existing building and rebuild like building (Andover, Charleston)
- Repair/modernize existing building and construct new building on excess land (Portland)
- Construct new building on underutilized land and outlease existing buildings and property (Seattle)
- Repair/modernize existing building and construct new space (GSA HQ, FOB 9)
- Tenant mix varies: all federal, federal and private sector, and federal and retail space

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GSA Properties Analyzed

Property	Tenants	Building size (square feet)	Current occupancy rate (percentage)	Funds from operations ($) fiscal year 2000	Notes
Seattle, WA	Army Corps of Engineers, FBI motor pool, out-lease warehouse space	607,543 rentable (mixed-use) 200,000 office	Office: 8% Warehouse: 80% Motor pool: 100%	$ 3,293,485	Army Corps of Engineers believes that it must relocate to a facility that meets seismic standards
Washington, DC FOB 9	Office of Personnel Management (OPM)	768,530 gross 673,924 rentable	98%	$9,922,041	Delegated building
Portland, OR	Immigration and Naturalization Service (INS)	137,281 gross 122,505 rentable	50%	$(207,980)	May be hard to retain INS at end of lease in fiscal year 2002 if building needs are not addressed
Washington, DC GSA HQ	GSA Headquarters	710,431 gross 623,233 rentable	100%	$4,456,891	
Columbia, SC	Veterans Affairs (VA)	83,640 gross 802,249 rentable	100%	$332,684	
Andover, MA	Internal Revenue Service (IRS)	400,502 gross 393,520 rentable	100%	$2,016,191	Delegated building --IRS pays its operating costs
Washington, DC FOB 8	Food and Drug Administration (FDA)	522,491 gross 479,840 rentable	100%	$12,362,825	FDA to vacate building and return it to GSA in 2002, clean of any environmental hazards
Charleston, SC	Unoccupied	99,695 BOMA	0	$(1,003,372)	Building vacant since 1999 due to damage from Hurricane Floyd
Jacksonville, FL	U.S. District Courts U.S. Postal Service	290,855 gross 278,870 rentable	94%	$1,517,038	Courts will move to new courthouse in 2002
Minneapolis, MN	Military Enlistment Processing Service (MEPS)	154,049 gross 143,197 rentable	10%	$599,365	MEPS plans to vacate building June 2001

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Summary of GSA Properties Analyzed in Year 10 of a 50 Year Partnership

Property	Private sector investment[1]	Government's investment [2]	Private partner IRR	Government IRR	Federal facility demand	Private sector interest [3]	Non-federal market demand
Seattle, WA	$74.5 M	$28.6 M	17.7%	9.6%	✔+	✔+	✔+
Washington, DC FOB 9	$121.1 M	$32.7 M	17.3%	15.1%	✔+	✔+	✔+
Portland, OR	$46.3 M	$4.8 M	15.7%	12.7%	✔+	✔+	✔
Washington, DC GSA HQ	$111.7 M	$29.8 M	15.3%	15.1%	✔+	✔+	✔+
Columbia, SC	$9.2 M	$2.4 M	14.5%	6.6%	✔+	✔-	none
Andover, MA	$233.0 M	$17.3 M	14.4%	9.4%	✔+	✔	✔+
Washington, DC FOB 8	$52.4 M	$14.0 M	13.7%	13.0%	✔+	✔	✔-
Charleston, SC	$30.5 M	$4.7 M	13.7%	9.9%	✔-	✔-	✔-
Jacksonville, FL	$23.3 M	$10.0 M	12.4%	6.1%	✔-	none	✔-
Minneapolis, MN	$13.0 M	$8.6 M	10.3%	0%	✔-	none	none

✔+ = strong ✔= moderate ✔- = weak

Table notes:
[1]The private sector investment includes contributed capital and financing obtained by the private sector investor.
[2]The government's investment is the value placed on the property that the government is contributing to the partnership.
[3]Based on the assumption that the private sector would desire a 15% IRR in year 10 to become involved with the project.

Source: Ernst & Young and AEW Capital Management, L.P.

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Appendix 1: GSA Properties Analyzed by Consultants

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Seattle, WA
Federal Center South

Current Conditions

- 39 acre site in an industrial area
- 4 functionally obsolete buildings totaling 607,543 rsf (200k office)
- Corps of Engineers (current tenant) has determined it must relocate to seismic-safe facility
- Waterway frontage and dock represent a valuable asset
- Strong federal demand for new federal office building

Redevelopment Strategy Analyzed

- Build new federal office building on 15 acres
  - 300,000 sf in year 1
  - 200,000 sf in year 3
- Sublease 5 acres of land for industrial use (existing parking lot)
- Sublease existing office/warehouse buildings and remaining 11 acres of land along waterfront to Port Authority (or equivalent)

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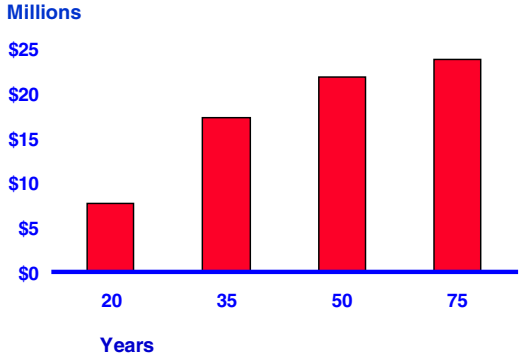
Seattle, WA
Federal Center South

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 9 percent		$2,346,750
Net cash flow share	$1,191,842	$1,787,762
Total	**$1,191,842**	**$4,134,512**
Projected lifetime IRR	**9.6%**	**17.7%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: Ernst & Young

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Washington, D.C. Theodore Roosevelt Building--FOB 9

Current Conditions

- Designed in an "H-shaped" configuration
- Currently occupied by the Office of Personnel Management
- 768,530 gross square feet

Redevelopment Strategy Analyzed

- Complete redevelopment of the existing structure
- New construction on the north and south sides to maximize buildable site
- Total 1,038,998 gross square feet and 833,150 rentable square feet

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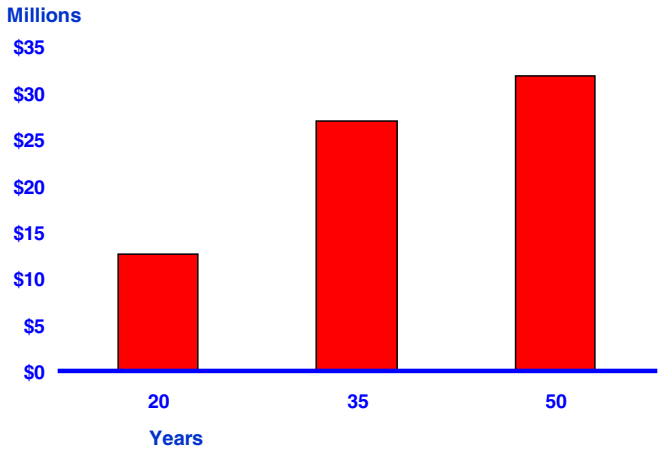
Washington, D.C.
Theodore Roosevelt Building--FOB 9

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 11 percent		$5,395,500
Net cash flow share	$40,900	$61,350
Total	**$40,900**	**$5,456,850**
Projected lifetime IRR	**15.1%**	**17.3%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: AEW Capital Management, L.P

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Portland, OR
511 Building

Current Conditions

- Historic building, 6 floors
- Desirable location between CBD and trendy "Pearl District" redevelopment submarket
- Existing federal demand supports renovation and new office tower
- Historic property includes parking lot sought by City for North Park Mall (pedestrian mall) extension
- Current costs to maintain the property exceed revenues

Redevelopment Strategy Analyzed

- Renovate historic building
  - storage use in basement
  - retail or restaurant on first floor
  - general office use on 2nd – 6th floors
- Construction of 240,000 sf federal office building across the street
  - Additional site acquired through trade/cross-lease of GSA parking lot for city-owned lot

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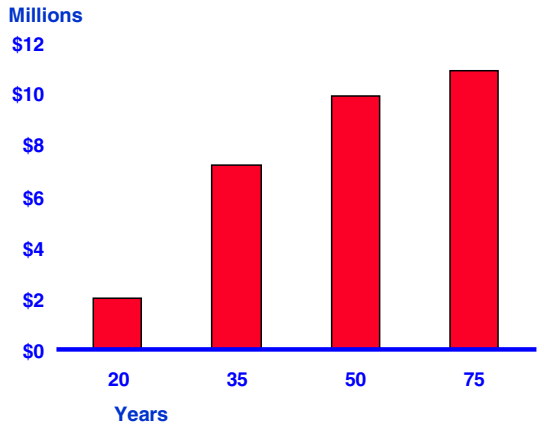
Portland, OR 511 Building

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 9 percent		$1,458,914
Net cash flow share	$527,383	$791,075
Total	**$527,383**	**$2,249,989**
Projected lifetime IRR	**12.7%**	**15.7%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: Ernst & Young

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Washington, D.C. GSA Headquarters Building

Current Conditions

- Originally completed in 1917 to house the Department of the Interior
- Unique "E-shaped" configuration
- 710,431 gross square feet of inefficient space that yields 623,233 rentable square feet
- Excellent location in the Central Business District close to the White House

Redevelopment Strategy Analyzed

- Complete redevelopment of the existing structure
- Significant new construction adding office space within the courtyard areas
- Total new space of 1,000,000 gross square feet with 850,000 rentable square feet

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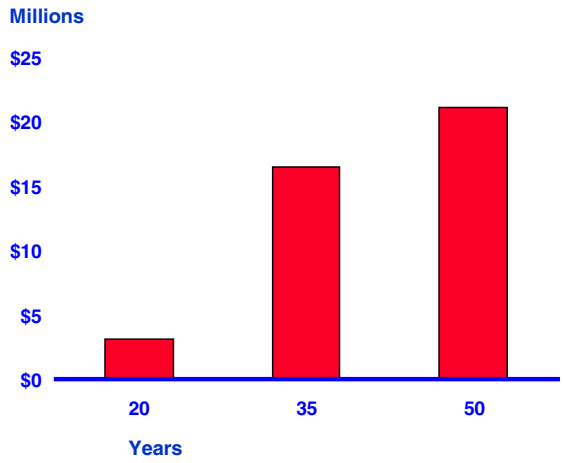
Washington, D.C. GSA Headquarters Building

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 11 percent		$4,917,000
Net cash flow share	$966,219	$1,449,329
Total	**$966,219**	**$6,366,329**
Projected lifetime IRR	**15.0%**	**15.3%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: AEW Capital Management, L.P

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Columbia, SC
VA Regional Office Building

Current Conditions

•80,249 sf building occupied by Veterans Affairs (VA) in need of renovation to retain occupancy

•Not efficient for VA's use

•Building is one in a complex of four federal buildings

•Relatively small project – could limit private sector developer interest

Redevelopment Strategy Analyzed

•Completely renovate existing VA Regional Office Building
•No excess land for development
•Parking to be provided by new parking garage to be completed in June 2001, for all federal buildings in the complex

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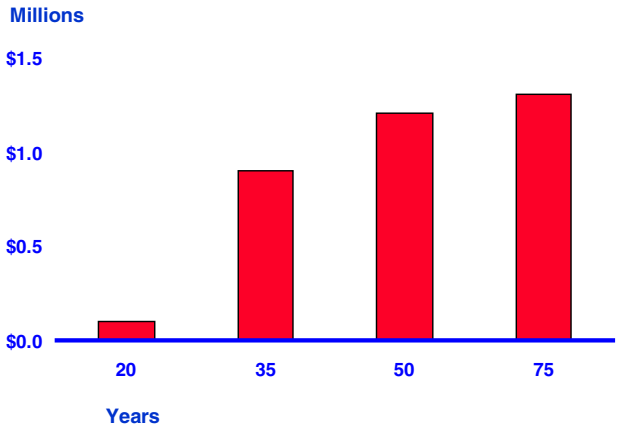
Columbia, SC
VA Regional Office Building

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 11 percent		$289,800
Net cash flow share	$51,881	$77,821
Total	**$51,881**	**$367,621**
Projected lifetime IRR	**6.6%**	**14.5%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: Ernst & Young

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Andover, MA
IRS Service Center

Current Conditions

- 375,000 sf single story, highly-secured building on 37 acre site in need of capital repairs
- IRS currently leases 336,000 sf in additional office space in the area
- Desire to consolidate IRS operations from numerous locations
- Highly desirable site to City and local developers

Redevelopment Strategy Analyzed

- Partnership to develop a small office park consisting of six, 5-acre pads
- Year 1
  - Build new 4 story 700,000 sf IRS facility and parking structure for current and expiring IRS leases
  - Complex would be at rear of site to allow for security and a phased development of the rest of site
- Year 2
  - IRS moves into new facilities and the old building is demolished
  - Partnership constructs another 250,000 sf federal office building for non-IRS expiring leases
- Years 3 & 4
  - Partnership constructs two more 250,000 sf federal office buildings for compatible agency and private sector occupancy

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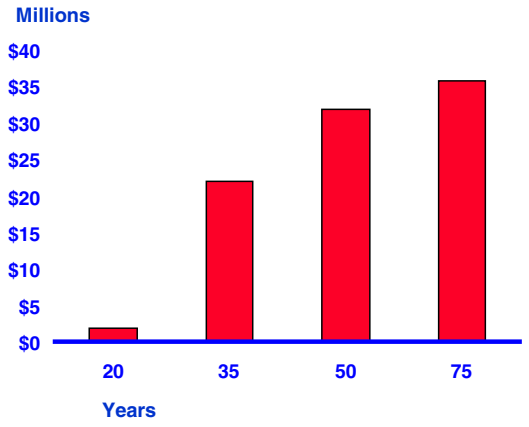
Andover, MA
IRS Service Center

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 9 percent		$7,339,500
Net cash flow share	$1,271,158	$1,906,737
Total	**$1,271,158**	**$9,246,237**
Projected lifetime IRR	**9.4%**	**14.4%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: Ernst & Young

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Washington, D.C. Federal Office Building 8

Current Conditions

- Eight level building specifically constructed to house the Food and Drug Administration (FDA)
- FDA is scheduled to vacate the building in 2001 and return it to GSA, free of FDA-generated hazardous materials, in 2002
- Very desirable location, proximity to the Capitol, Smithsonian, and the Mall

Redevelopment Strategy Analyzed

- Completely renovate the building to greatly update and functionally improve the space
- Recapture existing laboratory space as office and add an additional 150 parking spaces to the existing 50 in the basement level.

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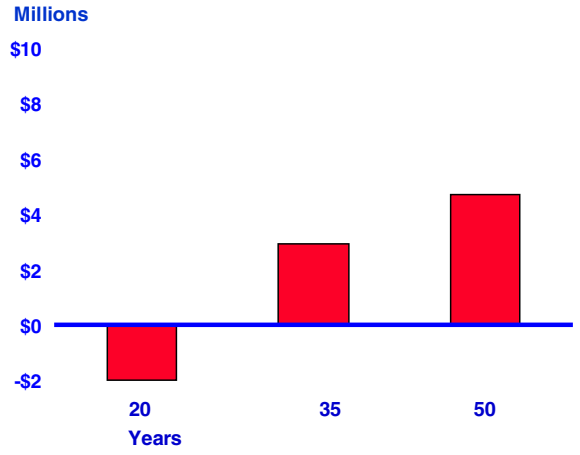
Washington, D.C. Federal Office Building 8

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 11 percent		$2,310,000
Net cash flow share	$781,470	$1,172,206
Total	**$781,470**	**$3,482,206**
Projected lifetime IRR	**13.0%**	**13.7%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: AEW Capital Management, L.P.

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Charleston, SC
L. Mendel Rivers Federal Building

Current Conditions

- 7-story 99,695 sf office building on a 2.18 acre site
- Contaminated, unoccupied building (asbestos) requires demolition and site redevelopment
- Costs incurred to maintain the property with no revenues generated
- Highly desirable location and land value – strong potential for private sector demand

Redevelopment Strategy Analyzed

- Demolish existing structure
- Construct 150,000 SF federal office building with structured parking
- First floor bank with drive thru and upper floors for federal agencies and private backfill

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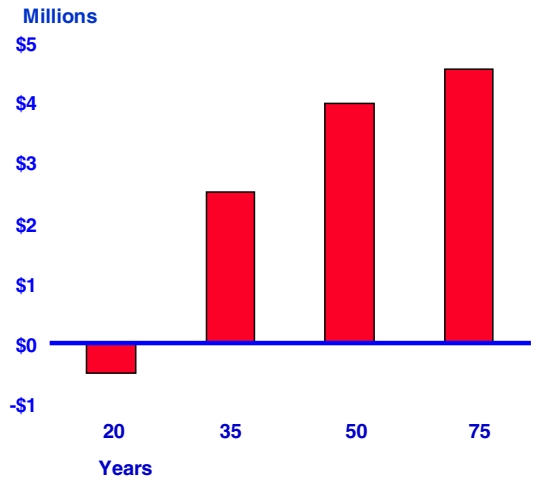
Charleston, SC
L. Mendel Rivers Federal Building

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 9 percent		$961,370
Net cash flow share	$279,928	$419,892
Total	**$279,928**	**$1,381,262**
Projected lifetime IRR	**9.9%**	**13.7%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: Ernst & Young

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Jacksonville, FL Courthouse

Current Conditions

- Six story historic courthouse in need of complete renovation
- Occupied by US Courts (moving to new building in July 2002)
- Federal demand exists but agencies tend to resist the Central Business District location (due to access and parking constraints)
- GSA recommended disposal; further action pending
- City of Jacksonville is interested in acquiring the property

Redevelopment Strategy Analyzed

- Renovation of the structure with historical property limitations
- Convert to general office use with first floor used by U.S. Postal Service

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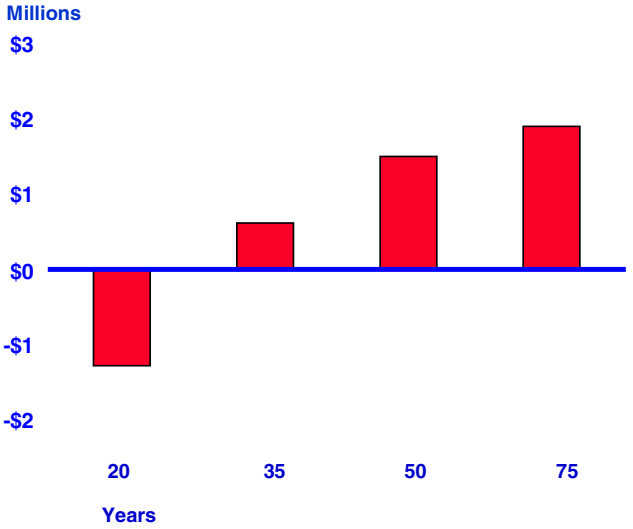
Jacksonville, FL Courthouse

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @ 9 percent		$735,482
Net cash flow share	$119,524	$179,286
Total	**$119,524**	**$914,768**
Projected lifetime IRR	**6.1%**	**12.4%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: Ernst & Young

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Minneapolis, MN Federal Office Building

Current Conditions

- 143,197 rentable sf historic building
- Sole tenant (DOD) occupies 10% of the building and is vacating in June 2001
- Limited potential federal use/demand
- Weak prospects for private sector backfill
- Historic eligibility limits site redevelopment potential

Redevelopment Strategy Analyzed

- Renovate the existing historic building
  - basement to be used for telecom hotel, open office, or tenant storage
  - 1st floor for restaurant or retail use
  - 2nd and 3rd floors for general office use
  - Continued use of 65 parking spaces, pro-rata by tenants
- Option of connecting to skyway at a cost of $1,500,000

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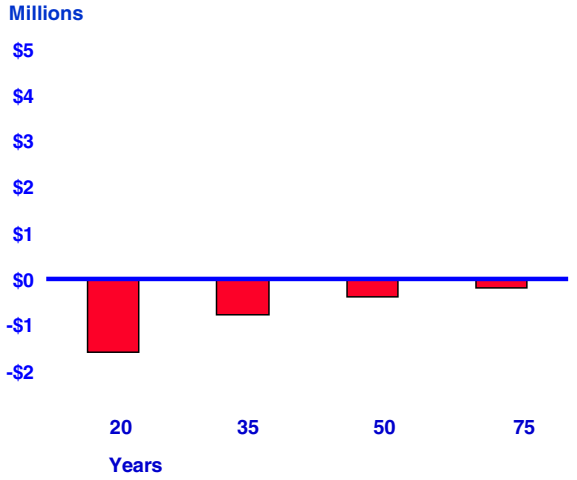
Minneapolis, MN Federal Office Building

Potential Proceeds to Partners (50 Year Master Lease)

	Government partner	Private partner
Net cash flow in year 10		
Preferred return @9 percent		$231,742
Net cash flow share	$---	$---
Total	**$ ---**	**$231,742**
Projected lifetime IRR	**0.0%**	**10.3%**

Master Lease Term Comparison Net Present Value of Developer's Cashflows



Source: Ernst & Young

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Appendix II: Comments From GSA

GSA Public Buildings Service

June 28, 2001

Mr. Bernie L. Ungar
Director, Physical Infrastructure Issues
General Accounting Office
Washington, DC 20548

Dear Mr. Ungar:

Thank you for the opportunity to comment on your draft of "Public-Private Partnerships: Pilot Program Needed to Demonstrate Actual Benefits of Using Partnerships." The General Services Administration is pleased to see that GAO supports the use of public-private partnerships as a viable strategy to help GSA repair its aging real property infrastructure. We also agree with the basic premise of the report that private developers are likely to be significantly interested in collaborating with GSA to renovate many of its properties.

The authority to enter into public-private partnerships would be one of a range of tools GSA is using to address the physical condition of its real property inventory and ensure that the Federal Buildings Fund (FBF) can support the ongoing repair and alteration needs of the agency's owned inventory. These tools are as follows.

- New focus for repair and alteration funding. It is now clear that it will be difficult for GSA to meet its entire repair and alteration needs solely through the FBF. *Therefore, GSA is dramatically reorienting its repair and alteration program to those buildings in its inventory that are prime contributors to the FBF.*

- Disposal of buildings that represent a net loss to the FBF. GSA is taking a more proactive approach to the disposal of buildings in need of repairs and alterations that are not net contributors to the FBF.

- Outleasing to the private sector. GSA has made full use of its authorities under the Cooperative Use Act of 1976 and the National Historic Preservation Act of 1966. Under these two limited authorities, GSA generated almost $13 million in revenues in fiscal year 2001. Each year, almost all of these revenues are spent on repairs and alterations.

- Special pricing. GSA must, by statute, charge commercially equivalent rates for its space. In some cases, however, GSA has obtained permission from OMB to price some existing, unique space in its owned inventory, e.g., certain courthouses, based on the cost of renovating the building.

U.S. General Services Administration
1800 F Street, NW
Washington, DC 20405-0002
www.gsa.gov

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We also note, for the record, that we have informally provided detailed editorial comments on your report. If you have any questions or require further information, please contact Mr. Brian Polly, Acting Assistant Commissioner for Portfolio Management, at (202) 501-0638.

Sincerely,

Paul Christoline

F. Joseph Moravec
Commissioner

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Glossary

BOMA	Building Owners and Managers Association International, a trade association of the office building industry, that developed a standard method of floor measurement in square feet for commercial real property.
Cash Flow	Net operating income minus master ground lease, debt service, and replacement reserve.
Central Business District	A designated downtown section of a city, generally consisting of retail, office, hotel, entertainment, and government land uses with some high-density housing.
Debt Service	Amount required for payments of interest and principal (often insurance and tax escrows, too) on money owed.
Discount Rate	Percentage rate used in discounting cash flows in calculations of net present value.
Federal Budget Scoring	The process of estimating the budgetary effects of pending and enacted legislation and comparing them to limits set in the budget resolution or legislation. Scorekeeping tracks data such as budget authority, receipts, outlays, and the surplus or deficit.
Gross Square Feet	Total enclosed floor area of a building measured in square feet.
Ground Lease	A lease for the use and occupancy of land only for a period of time.
Interest Rate	The rate of return charged by a lender for the use of funds, expressed in the form of a percentage per year.
Internal Rate of Return	The present value interest rate received for an investment consisting of payments and income that occur at regular periods; measures the return, expressed as an interest rate, that an investor would earn on an investment.

Lease	A written agreement between the property owner and a tenant (lessor) that stipulates the conditions under which the tenant (lessee) is entitled to use the property (in this case, real property) in return for periodic payments (rent) for a specified period of time.
Master Lease	A controlling lease under which all other interests in the real property are subordinate; for example, if a master lease is for a 5-year term, a sublease cannot legally exceed 5 years.
Net Cash Flow	Cash flow minus preferred return to the private partner.
Net Operating Income	Operating income minus operating expenses.
Net Present Value	Method of converting a cash flow stream over a number of years into the value of that money today, using an appropriate discount rate, in order to make investment decisions.
Operating Expenses	Broad term used to describe the expenses incurred in ordinary recurring activities of a property as opposed to nonrecurring items.
Operating Income	Earnings from normal operations that do not take into account proceeds from nonrecurring items.
Preferred Return	A distribution of income to the private partner prior to the distribution of net cash flow in accordance with the terms of the partnership, generally to compensate the private partner for its cost of capital and risk incurred.
Present Value	Value today (or at some specific date) of an amount to be paid or received later.
Public-Private Partnership	An arrangement by which the federal government contributes real property and a private entity contributes financial capital and borrowing ability to redevelop or renovate real property to serve, in part or in whole, a public need.

Rentable Square Feet	A term used in the commercial real estate market that includes occupiable square feet plus the tenants' proportional share of common building areas, such as rest rooms, exit stairways/fire corridors, and lobbies.
Replacement Reserve	Amount set aside from net operating income to pay for renovation or replacement of short-lived assets.
Square Foot	Unit of area measurement equal to a square measuring one foot on each side.
Sublease	An arrangement whereby a lessee leases the property to a different end user while the lessor maintains ownership and the lessee retains all of its obligations under the lease; terms cannot exceed that of a master lease.

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