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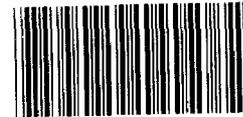
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FEDERAL REAL
PROPERTY

Key Acquisition and
Management Obstacles

Statement of J. William Gadsby
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General Government Division



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FEDERAL REAL PROPERTY:
KEY ACQUISITION AND MANAGEMENT OBSTACLES

SUMMARY OF STATEMENT OF
J. WILLIAM GADSBY
DIRECTOR, GOVERNMENT BUSINESS
OPERATIONS ISSUES

With an enormous real estate portfolio of almost 450,000 buildings, 3 billion square feet of space, and 650 million acres of land worth hundreds of billions of dollars, the United States Government is one of the world's largest property owners. The government leases another 200 million square feet of building space and 900,000 acres of land. This real estate is under the custody and control of at least 30 federal agencies and overseen by numerous congressional committees and subcommittees.

Public buildings and land are an integral part of carrying out federal operations. They should be viewed and used as capital resource tools to support agencies' goals and missions. They should be strategically acquired, managed, and disposed of so that taxpayers' return on investment is maximized. This is especially challenging in today's environment. About half of the government's office buildings are over 40 years old and were designed and located to meet the needs of an earlier era.

GAO's extensive body of work in the real property management area has identified five key obstacles that inhibit the government's ability to acquire and manage real property mission assets in a more cost-effective, businesslike manner. These obstacles are (1) GSA's monopoly in providing office space and its preoccupation with day-to-day real property operations, (2) a lack of strategic focus and needed information for capital spending decisions, (3) poor asset management practices, (4) Federal Buildings Fund shortfalls, and (5) budget scorekeeping rules that are biased in favor of operating leases over real property ownership.

Reforms have been proposed or are being studied by GAO and others to remove these obstacles. GAO senses that the new leadership team at GSA is open to fresh thinking about these issues and that there is also a broader interest in Congress concerning public building issues. GAO is encouraged that this new leadership and interest could produce a fundamental reassessment of public buildings policy.

Mr. Chairman and Members of the Subcommittee:

We welcome this opportunity to appear today in connection with your oversight of federal real property management. My testimony focuses on five key obstacles that inhibit the federal government's ability to strategically acquire and manage real property that is used to carry out agency missions in a cost-effective, businesslike manner. These obstacles are (1) the General Services Administration's (GSA) monopoly in providing office space and its preoccupation with day-to-day real property operations, (2) lack of a strategic focus and information for capital spending decisions, (3) poor asset management practices, (4) Federal Buildings Fund (FBF) shortfalls, and (5) budget scorekeeping rules that are biased in favor of operating leases over real property ownership.

As the attachment to my statement shows, we have addressed these issues in a series of reports and testimonies over the past 4 years. We also have work under way on several federal real property issues. My testimony today is based on this body of completed and ongoing work. However, before I get to the obstacles, I would like to provide some perspective on the government's extensive real property holdings and management.

Interior; and the National Aeronautics and Space Administration. GSA is the government's principal real estate agent and provides office space and other real property services to most federal agencies. In fiscal year 1993, GSA expects to spend over \$7 billion on governmentwide public buildings activities.

Public buildings and land are an integral part of carrying out federal operations. As such, they should be viewed and used as capital resource tools to support federal agencies' goals, policies, and missions. In that context, they should be strategically acquired, managed, and disposed of so that the taxpayers' return on the investment in them is maximized.

Management of federal real property is especially challenging in today's environment. About half of the government's office buildings are over 40 years old and were designed and located to meet the needs of an earlier era. In addition, rapidly changing information management and telecommunications capabilities will continue to influence changes in building design needs and workplace location practices. For example, there will be a diminished need for operations to be consolidated or located in high-cost central business districts or even in metropolitan areas. Also, the need for office space will decrease as the government downsizes and if more employees work at home using personal computers, modems, and FAX machines.

When GSA was created in 1949, highly centralized, monopolistic institutions were viewed as necessary to obtain economies of scale. Today, GSA still has a virtual monopoly over office space and certain other mission support services in that federal agencies, with some exceptions, must obtain them from GSA. But this monopoly and focus on its day-to-day service provider role have caused GSA to neglect its more strategic central management agency responsibilities.

Bills introduced in the last as well as this Congress would require that GSA's operations be periodically reauthorized. While the primary purpose of reauthorization would be to improve legislative oversight, it would also provide a forum to establish specific goals and objectives for GSA related to its central management role and hold it accountable for achieving them. We support the concept of periodic reauthorization for these purposes.

Bolder steps would be to separate GSA's governmentwide real estate policy and oversight functions from its operations functions and suspend its monopoly to give federal agencies the option of choosing to obtain office space and related services from GSA or directly from the private sector. Such steps have been taken in other countries and could help make federal real property activities more competitive and responsive to agencies viewed as customers rather than clients.

construction. But GSA cannot take advantage of these options because it lacks purchase authority.

During the last Congress, S. 2068 would have required that GSA biennially provide Congress information on total building capital investment needs and proposed building leases and disposals, including the relative benefits and costs of each proposed project. Such a mandate, which we have endorsed and continue to believe is worthwhile, could guide capital investment in public buildings, bolster congressional oversight and decisionmaking, and help ensure that scarce FBF dollars are spent more wisely. With such information, the existing prospectus approval threshold of \$1.65 million could be raised or possibly even eliminated.

Also, consideration could be given to providing GSA some discretionary building purchase authority--particularly while market conditions favor purchase over new construction--provided it can demonstrate that such purchases are a good deal for the taxpayer.

Poor Asset Management Practices

Management of the government's enormous real estate portfolio provides little assurance that federal buildings and associated land are managed, maintained, used, and disposed of in the most cost-effective manner. Two basic issues will help illustrate

Relatively little excess federal real property has been reported to GSA, and most agencies have a disincentive to do so because they generally get nothing for it. By law, proceeds from GSA sales of agencies' excess property usually must be deposited into the Land and Water Conservation Fund. In addition, GSA and most other federal agencies do not know the market value of their property and pay no penalty for using it inefficiently.

GSA also lacks a practical ability to remove office buildings from its own portfolio, especially ones with historical significance, that have exceeded their useful life or are no longer needed or cost effective to operate or renovate. As indicated earlier, more than half of GSA's office buildings are over 40 years old, some require extensive repairs and/or renovations, and several are on the national register of historic places. In some cases, these old and/or historic office buildings may have a negative return on investment as office buildings and could be better used for other purposes. For example, truly historic buildings could be retained as museums.

A contributing factor to the inability to dispose of assets is that GSA's asset reutilization and disposal activities are separate from its asset acquisition and management activities. Reutilizations and sales of real estate are an integral part of overall asset life-cycle management. But GSA's Federal Property Resources Service is responsible for governmentwide real estate

over the 10-year period ending in 2002. Our work has identified three principal reasons for this shortfall--rent restrictions OMB and Congress have imposed over the years, conceptual flaws in the fund's design, and the cost of increased reliance on leased space.

While most rent restrictions have now been eliminated, periodic restrictions since 1975 reduced available fund revenue by about \$5 billion (in 1993 dollars). This is money that, subject to obligation limitations carried in annual appropriation acts, could have been used to finance capital investment in the federal buildings infrastructure.

Also, the cumulative shortfall in the funds available for capital investment is attributable at least in part to conceptual flaws in the fund's design. FBF rent payments, which replaced direct congressional appropriations to GSA in 1975, were expected to provide a financial incentive for agencies to reduce their space costs and a steadier, more predictable source of funds for GSA. But, the FBF concept of requiring agencies to budget and pay for the space they occupy has not provided the expected financial incentive or the necessary discipline to reduce space costs. Agencies and their congressional appropriations subcommittees essentially treat rent payments to GSA as a "pass-through." In addition, FBF revenues, which are based on local prevailing commercial rental rates, are not directly related to the

proceeds from dispositions of federal real estate as an additional source of revenue for new capital investment.

Further Study of Budget

Scorekeeping is Needed

Our work has shown that GSA could save billions of dollars by increasing the amount of federally owned space and reducing leased space. Current budget scorekeeping rules serve as disincentives for increasing ownership because they are biased in favor of operating leases and drive decisionmakers toward the continued use of costly leases. These rules require that the total budget authority for building construction, purchase, or lease purchases be recognized up-front in the year the project is proposed. In contrast, the rules for ordinary operating leases only require that the current year's lease costs be recognized.

These rules place ownership and lease-purchase alternatives at a disadvantage when compared to an operating lease during budget deliberations making the operating lease option appear to be less costly. In practice, however, some leases could be more costly over the long run because GSA typically (1) enters into multiyear leases that are used to house permanent activities of government, (2) makes annual payments over the entire lease period, and (3) either renews the lease or signs a new one.

RELATED GAO PRODUCTS

Budget Policy: Federal Capital Budgeting (GAO/T-AFMD-93-7, May 26, 1993).

Federal Buildings Fund Limitations (GAO/GGD-93-34R, Apr. 5, 1993).

Transition Series: General Services Issues (GAO/OCG-93-28TR, Dec. 1992).

General Services Administration: Actions Needed to Improve Protection Against Fraud, Waste, and Mismanagement (GAO/GGD-92-98, Sept. 30, 1992).

Federal Office Space: Obstacles to Purchasing Commercial Properties From RTC, FDIC, and Others (GAO/GGD-92-60, Mar. 31, 1992).

Real Property Management Issues Facing GSA and Congress (GAO/T-GGD-92-4, Oct. 30, 1991).

GSA: A Central Management Agency Needing Comprehensive Congressional Oversight (GAO/T-GGD-92-3, Oct. 29, 1991).

Long-Term Neglect of Federal Building Needs (GAO/T-GGD-91-64, Aug. 1, 1991).

Federal Buildings: Actions Needed to Prevent Further Deterioration and Obsolescence (GAO/GGD-91-57, May 13, 1991).

Facilities Location Policy: GSA Should Propose a More Consistent and Businesslike Approach (GAO/GGD-90-109, Sept. 28, 1990).

The Disinvestment in Federal Office Space (GAO/T-GGD-90-24, Mar. 20, 1990).

Federal Office Space: Increased Ownership Would Result in Significant Savings (GAO/GGD-90-11, Dec. 22, 1989).

Building Purchases: GSA's Program Is Successful but Better Policies and Procedures Are Needed (GAO/GGD-90-5, Oct. 31, 1989).

Public Buildings: Own or Lease? (GAO/T-GGD-89-42, Sept. 26, 1989).

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FEDERAL REAL PROPERTY
HOLDINGS AND MANAGEMENT

The U. S. Government is one of the world's largest real property owners. Its portfolio includes almost 450,000 buildings with a gross floor area of 2.8 billion square feet and 650 million acres of land that are worth hundreds of billions of dollars. The federal government leases another 234 million square feet of building space and 938,000 acres of land. In addition, it holds at least \$14 billion of real estate acquired from failed financial institutions, loan foreclosures and defaults, and law enforcement seizures.

This real property is under the custody and control of at least 30 federal agencies and overseen by numerous congressional committees and subcommittees, each with its own interests and expectations. Most of the government's real property holdings are national parks, forests, other public lands, and military facilities. The real estate acquired from failed banks and thrifts, and law enforcement activities is held pending liquidation by the government. But thousands of buildings and associated acres of land are owned or leased to support federal agencies' missions.

The largest civilian real property agencies are GSA; the Postal Service; the departments of Veterans Affairs, Energy, and the

OBSTACLES TO MORE COST EFFECTIVE, BUSINESSLIKE
FEDERAL REAL PROPERTY ACQUISITION AND MANAGEMENT

As I said at the outset, our work has identified five key obstacles that inhibit the government's ability to acquire and manage real property for the government's use in a more cost-effective, businesslike manner. I will briefly describe these obstacles and discuss some of the proposed reforms.

GSA's Monopoly and Preoccupation With Operations

Since its establishment in 1949, GSA has been torn between (1) an internal dynamic that emphasizes a centralized approach to the direct provision and operation of office space and other support services to federal client agencies and (2) a largely external expectation that its primary role should be to provide overall leadership and direction in this area. The attributes of this leadership role--generally supported by the agencies themselves, the Office of Management and Budget (OMB), and us--relate to providing a long-term property management strategy, common policies and knowledgeable guidance in implementing it, coordination to prevent waste and mismanagement among agencies, and comprehensive reporting and oversight for accountability purposes. We and others believe that GSA should continue to operate activities only where it makes sense and is cost effective to have a central management agency involved.

Lack of Strategic Focus

Information describing the most important federal office space needs and how they could be met cost effectively is essential to managing federal real property in a more businesslike manner. At present, GSA building capital and operating projects expected to cost more than \$1.65 million require congressional approval. To obtain this approval, GSA develops and submits to OMB and the House and Senate Public Works Committees detailed individual project descriptions with associated cost estimates called prospectuses. Although GSA is attempting to make its capital spending proposals more credible and convincing, its individual project-by-project prospectuses and budget submissions do not adequately put proposed projects in an overall strategic context or rank their relative cost effectiveness.

This lack of strategic focus discourages strategic thinking and planning and can adversely affect federal agencies' operations, encourage OMB and Congress to substitute alternative projects, and result in unsound capital spending decisions. In addition, it normally takes 3 to 5 years between prospectus initiation and congressional approval. During this period, costs can escalate, and agencies' space requirements as well as the commercial real estate and financial markets can change dramatically. RTC, FDIC, and the private sector have properties available that could satisfy federal office space needs at less than the costs of new

this problem: (1) limited governmentwide coordination and oversight of existing federal real property assets and (2) an inadequate asset disposition strategy and methodology.

Despite the number of federal agencies with real property responsibilities, there is no single agency to provide governmentwide strategic leadership, oversee agencies' real estate holdings and needs, or promote a life-cycle approach to asset management. Also lacking is an effective network for agencies to share ideas, discuss common problems, and identify and explore governmentwide solutions. GSA established a new Federal Property Asset Management Service (FPAMS) in November 1992 to take a more proactive governmentwide policy and oversight role in real property management. But in January 1993, this promising new Service was abolished and has not been reestablished.

Another long-standing problem is the inability to identify and dispose of real property assets that are no longer needed or cost effective to retain. Our work has indicated that the government may be incurring opportunity costs needlessly, since some of its buildings and land could be put to more cost-beneficial uses, exchanged for other needed property, or sold. Two factors contribute to this situation. The most important is the lack of financial incentives for agencies to dispose of property.

disposals, while its Public Buildings Service handles acquisition and management of GSA-controlled buildings. This separation also inhibits effective communication, coordination, and teamwork. Again, FPAMS could contribute to solving this structural problem.

The government's overall management and oversight of federal real property could be improved by (1) increasing the use and application of generally accepted private sector asset management concepts, such as long-range planning, economic analyses, and utilization assessments in making building retention decisions; (2) devising a governmentwide strategy, approach, and any needed incentives and penalties for reducing federal space requirements and associated costs and identifying unneeded or underutilized space; (3) separately identifying expenditures and associated opportunity costs for historic building preservation projects so that decisionmakers know the economic implications, and (4) reestablishing FPAMS.

Federal Buildings Fund Shortfalls

The FBF has not generated enough revenue to finance identified capital investment needs in new and/or existing buildings. Congress added a total of \$3.5 billion to the fund in 1990 and 1991 to allow GSA to construct several new federal buildings. But as of May 1992, the fund still was expected to fall \$7 billion short of meeting GSA's projected capital investment needs

projected costs of long-term federal asset replacement. Also, the operating costs and capital needs of federal buildings, especially courthouses, typically are greater than those of commercial office buildings.

Finally, the increasing reliance on leased space is resulting in less money available for capital investment. Over the next 10 years, GSA's spending for leased space is projected to increase, while spending for new building construction or purchases is expected to remain relatively constant. GSA currently pays about \$2 billion annually for leased space. As of May 1992, GSA projected that its lease costs would rise to \$3 billion by 2002. Between 1993 and 2002, GSA expected to use about 45 percent of projected FBF revenues to pay for leased space and another 28 percent for various other building operating expenses. This would leave about 27 percent for capital investment.

S. 714, which the Senate recently passed, would require, among other things, an OMB study of alternatives to current FBF financing. The existing FBF financing mechanism clearly needs to be studied because GSA's projections show that supplemental borrowing and/or direct appropriations will continue to be periodically required to compensate for FBF rent revenue shortfalls. Alternatives could include (1) redesigning the existing FBF system to generate enough revenue to finance projected building capital and operating costs and (2) using the

To resolve this dilemma, the budget scorekeeping rules need to be studied to determine what changes are needed to put operating leases and ownership on a "level playing field." This change would allow decisionmakers to choose the lease option only when it makes sense and is the most cost-effective housing option available.

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Before closing, Mr. Chairman, I would like to note that a new leadership team has just begun to take charge at GSA. We sense already that GSA is open to fresh thinking about its mission and operational style, as evidenced by the thoughtful attention that has been given to our transition report and the extensive body of work set forth in the attachment to my statement. We also sense a broader interest in Congress in public building strategic issues, as exemplified by this hearing. We are encouraged that this new leadership and interest could well result in a fundamental reassessment of public buildings policy that could remove obstacles to strategic real estate management that my statement and our previous work have discussed.

This concludes my prepared statement, Mr. Chairman. We would be pleased to respond to any questions.

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