United States General Accounting Office
Washington, DC 20548

August 8, 2002

The Honorable Pete Sessions
House of Representatives

Subject: *Financial Condition of Federal Buildings Owned by the General Services Administration*

Dear Mr. Sessions:

As the federal government's real property manager, the General Services Administration (GSA) manages over 1,700 federally owned buildings that have about $5.7 billion in identified repair and alteration needs. During our work for you on public-private partnerships,[1] we discussed that GSA had or was at risk of having a negative net income from several of its buildings because of their deteriorating conditions. Several buildings were vacant or at risk of losing their tenants because of the condition of the buildings. Although GSA does not receive rental income on vacant buildings, it still incurs expenses to operate key building systems and secure the buildings. You asked us to provide information on the financial condition of GSA's owned-building inventory. As we began our work, however, GSA's Public Buildings Service (PBS) also began a review to, among other things, evaluate the financial condition of each of GSA's owned buildings. As a result, as agreed with your office, we did not conduct a review. Instead, this letter summarizes the results of PBS's efforts to date and its future plans regarding the owned-building inventory. To obtain this information we reviewed briefings and other PBS documents and interviewed PBS officials. We did not independently verify the information provided. PBS officials provided comments on a draft of this letter, which we incorporated.

PBS's Commissioner has described the owned-building inventory as predominantly aged with reinvestment needs that far exceed the capabilities of the Federal Buildings Fund (FBF). Repairs and alterations, as well as other capital and operating expenses associated with maintaining federal buildings, are financed by the FBF, a revolving fund administered by GSA. Rents that GSA receives from federal agencies are deposited into the FBF. The FBF has not generated sufficient income over the years to finance all the needs of the GSA buildings. For fiscal year 2002, an aggregate

[1]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). We define a public-private partnership as an arrangement in which the federal government contributes real property and a private entity contributes financial capital and has the borrowing ability to redevelop or renovate real property.

amount of $6.1 billion was available in the FBF for expenditure. This amount was authorized for expenditure as follows: 48 percent for rental payments, 29 percent for building operations, 14 percent for repairs and alterations, 6 percent for construction, and 3 percent for installment payments for acquisitions. Although authorized funding for repairs and alterations within the FBF has increased in 6 of the past 10 years, GSA does not expect the FBF to generate enough revenue through rental income to meet all the current and future needs of the current owned-building inventory. GSA also does not expect to receive direct appropriations to meet such needs.

Given the backlog of repair and alteration needs for federal buildings and its limited financial resources,[2] in June 2001 PBS undertook a review of GSA's owned-building inventory. Its goal was to develop a strategy to best align the portfolio with PBS's mission of providing responsible asset management. In January 2002, PBS's Commissioner approved a strategy to restructure and reinvest in GSA's owned-building inventory. PBS has stated that each building in the inventory should serve a predominant federal need and, at a minimum, generate sufficient income to cover its own upkeep. It concluded that GSA could no longer afford to keep buildings in the inventory that do not generate a positive income to the FBF.

GSA manages a total of 1,745 federally owned buildings. PBS used fiscal year 2001 data to conduct financial analysis of 1,375 of its owned buildings. Each building was placed into one of the four categories—nonperforming, poor, good, and solid—based on the results of the financial analysis. According to PBS, the 370 buildings that the team did not analyze were primarily border stations for which PBS was already working with the tenant agencies to establish rents that would cover these buildings' expenses.

- Buildings termed "nonperforming" do not meet the lowest test of generating sufficient income to cover their expenses and to set aside a minimal amount, 2 percent of the building's replacement cost, for future repair and alteration needs or replacement of the building. PBS plans to limit the capital expenditures made in these buildings.
- Buildings termed "poor" pass the lowest test of generating sufficient income to cover their expenses and the minimal reserve. However, these buildings have less than a 6 percent return on investment (ROI), and thus GSA may not consider them to be the best investment of resources. ROI shows how much the building is generating in income compared with the value of the building. These buildings are to be examined further to determine whether reinvestment in the buildings would likely yield higher returns. For example, the ability to recapture vacant space and make it available for rent could yield a high return.
- Buildings termed "good" pass the prior two tests and thus have an ROI of at least 6 percent, but the conditions of the buildings are considered poor and they

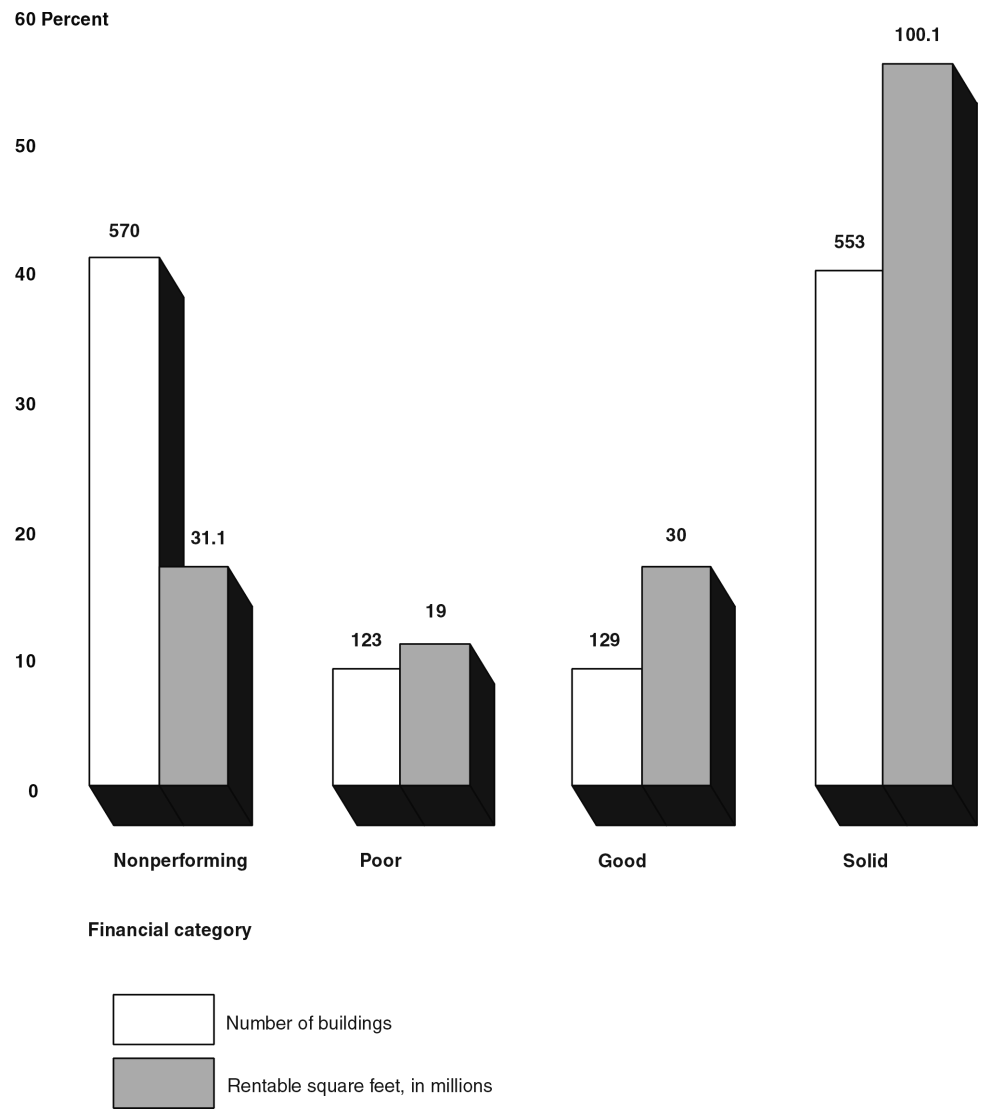
[2] U.S. General Accounting Office, *Federal Buildings: Funding Repairs and Alterations Has Been a Challenge—Expanded Financing Tools Needed*, GAO-01-452 (Washington, D.C.: Apr. 12, 2001). U.S. General Accounting Office, *Federal Buildings: Billions Needed for Repairs and Alterations*, GAO-00-98 (Washington, D.C.: Mar. 30, 2000).

have high reinvestment needs. According to PBS, these buildings are probable candidates for reinvestment, if funds are available.

- Buildings termed “solid” are those that generate more than 6 percent ROI and are in good condition, thus having relatively low reinvestment needs. These buildings would likely be held for the long term and would be priority reinvestment candidates in order to keep them from deteriorating.

Figure 1 shows the results of PBS’s analysis of 1,375 buildings with a total of 180.2 million rentable square feet of space. About half of the buildings, 693, fell into the “nonperforming” and “poor” categories, combined. However, these 693 buildings accounted for only 28 percent, or 50.1 million, of the rentable square feet of space. The other 682 buildings fell into the “solid” and “good” categories, combined. These buildings accounted for 72 percent, or 130.1 million, rentable square feet of space.

Figure 1: Percentage of Buildings and Rentable Square Feet of Space, by Financial Category



Source: Public Buildings Service.

Now that the owned buildings have been categorized based on their financial performance, the asset managers for each building, who are located in GSA's regional offices, are responsible for developing building-specific strategies. These strategies are to reflect the financial categories of the buildings. According to PBS officials, the strategies for the nonperforming buildings should be developed by December 31, 2002. They expect the strategies for the other buildings to be easier to develop—since for many of them the strategies will be to hold and maintain the buildings—and, thus, hope to complete them by the end of fiscal year 2002. PBS's Assistant Commissioner for Portfolio Management expects all the strategies to be fully implemented within 5 years; by that time, he expects virtually all of GSA's owned buildings to be self-sustaining and to serve a predominantly federal need.

Recognizing that responsibility for each GSA building is spread among its asset managers, who are located in its 11 regional offices, PBS created the Workout Task Force in its headquarters to manage and coordinate the development and implementation of the strategies. The task force has been working with, and is to continue to work with, the individual building asset managers regarding both the development and the implementation of the strategies. The task force plans initially to focus its efforts on those buildings in the nonperforming category because they are the biggest financial drain on the FBF. According to task force officials, possible strategies for nonperforming buildings include: disposal; exchange with other federal, state, or local agencies; renegotiation of rents; outlease to nonfederal tenants; transfer of the building to the tenants; and public-private partnerships, if GSA is provided this authority. According to PBS, it has already begun to implement the strategies for a number of buildings. For example, PBS said that many of its nonperforming buildings have been referred for disposal, and the number of buildings in the disposal process has increased significantly since last year. In addition, PBS said that it is in the process of renegotiating rents on several nonperforming buildings.

PBS plans to make its building assessment process continual. According to PBS, it plans to review the financial performance of each building annually, recategorize the buildings if necessary, review the strategy for each building, and adjust the strategies when necessary to reflect the building's current financial performance.

Please contact me at (202) 512-2384 or at ungarb@gao.gov if you or your staff have any questions. We are sending copies of this letter to the appropriate congressional committees. We will also make copies available to others upon request.

Sincerely yours,

Bernard L. Ungar

Bernard L. Ungar
Director, Physical Infrastructure Issues

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