

Audit Report

Review of Management Controls
over the Lease Prospectus Process

Report Number A070199/P/R/R09002
July 15, 2009

**Office of Inspector General
General Services Administration**



Office of Audits

GENERAL SERVICES ADMINISTRATION OFFICE OF INSPECTOR GENERAL

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U.S. GENERAL SERVICES ADMINISTRATION
Office of Inspector General

Date: July 15, 2009

Reply to: R. Nicholas Goco
Attn of: Deputy Assistant Inspector General
for Real Property Audits (JA-R)

Subject: Review of Management Controls over the Lease Prospectus Process
Report Number A070199/P/R/R09002

To: Anthony E. Costa
Acting Commissioner, Public Buildings Service (P)

This report presents the results of our review of the controls PBS has implemented to ensure leasing transactions adhere to the prospectus requirements defined by Title 40, United States Code (U.S.C.), Section 3307 on Congressional Approval of Proposed Projects. Section 3307 requires Congressional authorization for specific leasing actions if the annual net rent exceeds a certain dollar value. This is accomplished through the lease prospectus process.

Our review disclosed that, overall, PBS has implemented management controls at National Office and the Regions over the lease prospectus process. However, interpretation and implementation of National Office guidance varied at the Regional level. As a result, in some instances, a prospectus may not have been submitted or revised when necessary.

In October 2007, PBS National Office updated lease prospectus guidance, consolidating previous guidance into one comprehensive document. This guidance clarified fundamentals of the lease prospectus process that prior guidance had left open for interpretation. Although the October 2007 guidance is an improvement, further clarification is needed, especially with regard to supplemental lease agreements and situations where multiple leases might be construed as a single leasing action. PBS's treatment of multiple tenant agency space requests as separate and distinct leasing actions has resulted in co-located leases with very similar terms that, when combined, exceed the prospectus thresholds.

If you have any questions regarding this report, please contact me or R. Nicholas Goco, Deputy Assistant Inspector General for Real Property Audits, on (202) 219-0088.

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REVIEW OF MANAGEMENT CONTROLS OVER THE LEASE
PROSPECTUS PROCESS
REPORT NUMBER A070199/P/R/R09002

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EXECUTIVE SUMMARY

Purpose

The General Services Administration's (GSA) Office of Inspector General – Office of Audits (OIG) reviewed the management controls implemented by the Public Buildings Service (PBS) to ensure leasing transactions adhere to the prospectus requirements defined by Title 40, United States Code (U.S.C.), Section 3307.

Background

Some leasing actions require Congressional authorization (prospectus approval) if the annual net rent exceeds a certain dollar value. The “threshold amount” defines the dollar limitation above which a prospectus is required. GSA adjusts the threshold amount for lease prospectuses annually per Title 40 U.S.C. 3307(g).

Results in Brief

Overall PBS implemented management controls at National Office and the Regions over the lease prospectus process. However, we found that at the Regional level, interpretation and implementation of National Office guidance varied. As a result, in some instances, a prospectus may not have been submitted or revised when necessary. National Office updated lease prospectus guidance in October 2007. While the Regions we reviewed cited the updated guidance as an improvement, certain topics are still open to interpretation. We found:

- Supplemental Lease Agreements (SLAs) that increased lease parameters beyond prospectus thresholds;
- Situations where multiple leases might be construed as a single leasing action;
- Unique transactions which impacted prospectus evaluations;
- Prospectus analysis miscalculations;
- The Advanced Acquisition Program misused for awarding leases above the prospectus level threshold; and
- Leases were not normally monitored for prospectus compliance after lease award.

Recommendations

We recommend that the Commissioner of the Public Buildings Service:

1. Establish a consistent approach for evaluating leasing actions for prospectus compliance, especially for additional space requests, SLAs, and rent calculations;
2. Improve communication and coordination between the prospectus process participants;
3. Review the examples cited in our report to evaluate the current status of the leases and determine whether any leasing actions need to be reported to the appropriate Congressional committees;
4. Develop controls to monitor prospectus leases after award; and
5. Remove superseded prospectus guidance from PBS's internal websites or identify it as having been superseded.

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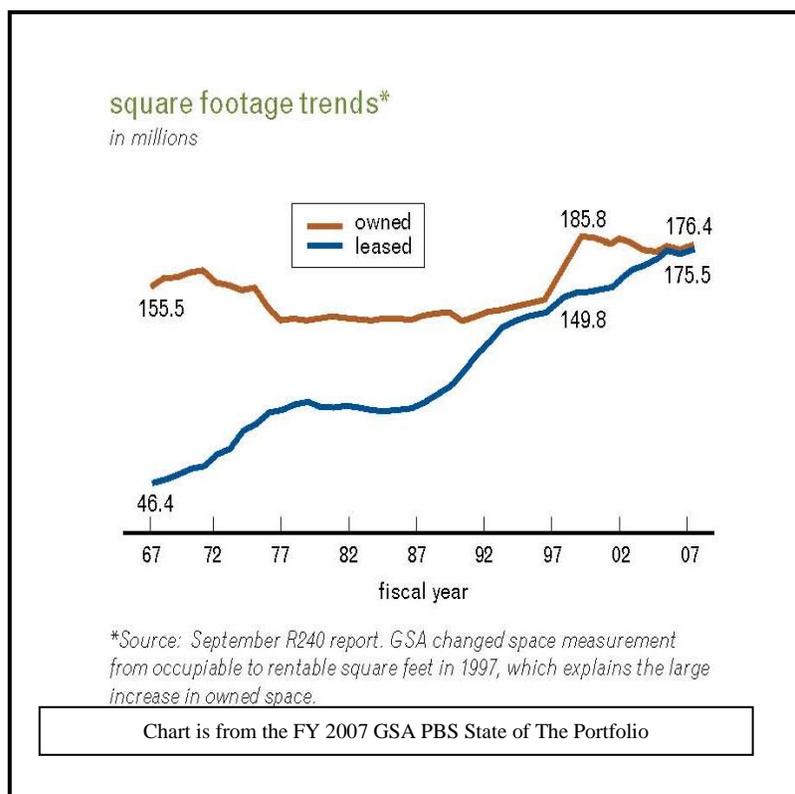
INTRODUCTION

Background

As illustrated in the chart, Federal leased space has continued to grow in both amount and as a percentage of total space. Over the 40-year period from 1967 through 2007, the majority of growth in the Public Buildings Service (PBS) inventory was through leasing, while owned space remained relatively stable. In fiscal year (FY) 2008, leased space represented over 50 percent of PBS's 353.9 million total rentable square feet (RSF) of inventory. This lease inventory produced direct revenue of almost \$4.9 billion.

Some leasing actions require Congressional authorization if the annual net rent exceeds a certain dollar threshold as codified by Title 40, U.S.C., Section 3307 on Congressional Approval of Proposed Projects. This is accomplished through the lease prospectus process. The prospectus document, which outlines and justifies the proposed lease, is used by the

General Services Administration's (GSA) authorizing committees to review proposed GSA leases prior to approval. To determine if a prospectus is necessary, the anticipated net annual rent of a proposed lease is compared to the prospectus threshold that applies to the fiscal year of lease award.¹ To determine net rent, operating expenses are subtracted from total annual rent. Operating expenses include the cost for heat, light, water, and janitorial services. Conversely, real estate taxes are a component of net rent, as are amortized costs for initial space alterations and lump sum payments made by GSA. If the lease calls for escalation of the base rent, a



¹ GSA adjusts the dollar thresholds for lease prospectuses annually in accordance with 40 U.S.C 3307(g). The FY 2009 prospectus threshold is \$2.66 million.

levelized rent must be calculated to determine whether a prospectus is needed. For leases with annual net rents that exceed threshold amounts, a prospectus must be prepared by the Region; submitted to GSA National Office for review; approved by the Office of Management and Budget (OMB); and, finally, submitted to, and approved by Congress.² As PBS internal documents note, the prospectus process succeeds as a partnership of customer agencies, GSA, OMB, and Congressional committees and is based on the belief of the participants in the integrity of the process. Because of the steps and participants involved in the lease prospectus process cycle, the process can take up to five years to complete from planning to tenant agency occupancy.³ The process also allows for amendments based on changes in requirements after prospectus submission.

Objective, Scope and Methodology

The objective of our review was to determine if management controls are in place to provide reasonable assurance that PBS leasing transactions adhere to prospectus requirements defined by Title 40, United States Code (U.S.C.), Section 3307. Our work was conducted in GSA's National Office and the National Capital, Northeast & Caribbean, and Pacific Rim Regions.

To gain an understanding of PBS's lease prospectus program, we reviewed prior audit reports issued by the Office of Inspector General (OIG) and the Government Accountability Office. We familiarized ourselves with PBS's National and Regional guidance; the prospectus process, schedule, and participating personnel; and program background and information systems. We also held discussions with PBS officials familiar with the prospectus process.

To accomplish our objective, we reviewed:

- A sample of 119 prospectus submissions, and corresponding leases, from FY 2001 through FY 2006 to determine if associated leases remained within Congressionally approved parameters; and
- August and December 2007 active lease databases to identify leases that might require a prospectus; a sample of 255 of approximately 8,590 active leases were selected for detailed review. The sampled leases were judgmentally selected and were awarded prior to issuance of the October 2007 revised prospectus guidance. The review focused on leases meeting the following criteria:
 - within 10 percent of the applicable fiscal year prospectus threshold;
 - with similar lease terms housed in the same building; and
 - with incremental space increases that put annual net rent at or above the applicable fiscal year prospectus threshold.

² Specifically, the Senate Committee on Environment and Public Works and the House Committee on Transportation and Infrastructure.

³ The cycle includes: lease planning 6 to 12 months before submission to National Office; National Office, OMB and Congressional review and approval (12 to 18 months); Regional Office competes and awards lease (9 to 12 months); design and construction of tenant space (12 to 24 months); and agency occupancy (up to 4 months to complete move in).

We requested, received and evaluated clarification from Regional officials for the issues identified during our review of the leases and prospectuses. Fieldwork was conducted between October 2007 and September 2008 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

Overall the Public Buildings Service (PBS) has implemented management controls at the National Office and the Regions over the lease prospectus. However, interpretation and implementation of previous National Office guidance varied. In October 2007, PBS National Office updated lease prospectus guidance, consolidating previous guidance into one comprehensive document. The recent guidance has clarified fundamentals of the lease prospectus process that prior guidance had left open for interpretation.

Although the new guidance is an improvement, further clarification is needed, especially with regard to supplemental lease agreements (SLAs). SLAs are the primary method used to change or modify an existing lease. In some cases, an SLA could trigger the need for a prospectus or an amended prospectus to be submitted to Congressional committees. However, the timing and scope of these changes may influence whether this needs to be done.

In addition, PBS needs to address situations where multiple leases might be construed as a single leasing action. PBS's treatment of multiple tenant agency space requests as separate and distinct leasing actions has resulted in co-located leases with very similar terms that, when combined, exceed the prospectus thresholds. While these leases are technically compliant with policy, they could be viewed as a single action. In many of these situations, the Advanced Acquisition Program (AAP) inventory may have been a contributing factor.

We also noticed leases with unique circumstances that impacted prospectus evaluations. Furthermore, there are additional control issues that need to be addressed. These include miscalculations in prospectus analysis, limited documentation on tenant requirements, leases not monitored for prospectus compliance after award, and the need for increased communication. For the lease prospectus process to function properly, improvement is needed in the coordination between the Regional Offices, National Office, and tenant agencies.

PBS has Issued Updated Guidance

During our review, PBS published a memorandum "Updated Lease Prospectus Guidance", dated October 31, 2007. The updated guidance supersedes older guidance, specifically citing the following documents: 1) *Interpreting the Lease Prospectus Threshold*, and 2) the *October 1999 Guidance on the Requirements for a Leasing Prospectus*. The memorandum also states that the guidance is part of an ongoing effort to foster consistency across the Regions and that it is the first of several clarifications and updates to be issued. The primary additions to the guidance included requirements regarding SLAs, particularly post award SLAs, and the need to obtain a prospectus for a lease within ten percent of the applicable prospectus threshold. In some cases, the updated guidance might have prevented certain issues we noted during our review.

We found that at the Regional level, interpretation and implementation of previous National Office guidance has varied. In general, there were variances in the Regions regarding how to process additional space requests from the tenant agency, and inconsistencies in defining what constitutes a separate and distinct leasing action; a topic not covered in former or current policy. As a result, in some instances, a prospectus may not have been submitted or revised when necessary. While Regions we reviewed cited the updated guidance as an improvement, certain topics require further clarification. For example, the updated guidance does not define terms such as “material”; clarify what is a separate and distinct leasing action, or describe the methodology for combining multiple approved prospectuses into a single lease.

Policy Requirements for Supplemental Lease Agreements are Improved, but Still Need to be Clarified

The October 2007 guidance included a section pertaining to SLAs. SLAs are the primary method used to change or modify an existing lease (e.g. acquisition of additional space, revision in terms or rental payments, or any other action that changes the lease).⁴

The updated guidance requires a check to determine whether a prospectus is required for any post-award SLA that would modify the cost per square foot, total annual cost, lease term, amount of space under the lease, or any other material change to the original lease agreement. This would require re-evaluation of the lease to ensure that:

- Below prospectus-level leases are still below the prospectus threshold;
- Prospectus-level leases are consistent with the terms of the prospectus and the authority provided; and
- Any modification, regardless of whether the original leasing action is above or below the prospectus threshold, does not introduce a scoring⁵ problem.

However, a Regional official stated that prior National Office guidance was “gray” in this area and open to interpretation. Lease files we reviewed contained variations in how SLAs were evaluated for prospectus implications. In certain instances, the files contained an analysis indicating the contracting officer evaluated the SLA prospectus implications based on the revised lease terms for the entire lease. In other instances, the SLA was treated as a standalone leasing action, and only the incremental increases in square footage and rent costs were evaluated for prospectus requirements.

As noted previously, the earlier guidance did not contain the specifics related to the treatment of SLAs. Therefore, we sought clarification from National Office officials knowledgeable in this area on the appropriate treatment of SLAs prior and subsequent to the updated guidance. They advised that the updated guidance consolidated previously existing guidance. They went on to explain that, if initiated prior to occupancy by the tenant agency, an SLA increasing square footage or cost should be incorporated into the lease for prospectus purposes. If the SLA pushes

⁴ Additional space requests can be accomplished by either executing an SLA or awarding an entirely new lease. The latter requires more time and effort, and typically must go through a competitive procurement process.

⁵ The Office of Management and Budget’s method for determining if a lease should be classified as a capital or operating lease for budget purposes.

a non-prospectus lease beyond the prospectus threshold, a prospectus should be sought. Also, if an SLA causes a prospectus lease to exceed approved parameters, an amended prospectus should be sought.

Post occupancy, however, is a gray area, with considerable room for interpretation. Facets such as materiality and timeframes are not defined. The key is whether significant changes to the lease were foreseen prior to lease award or were truly independent leasing actions raised by the tenant agency after initial lease award.

For our sample of leases/prospectuses, 21 percent had incremental increases in space from 2002 to 2006. This included 11 instances where SLAs were used to acquire additional space that either 1) increased the size of a non-prospectus lease beyond the prospectus threshold, or 2) pushed a prospectus level lease beyond approved parameters.

Additional Space is Added to a Non-Prospectus Level Lease, Pushing the Total Leased Net Rent Above the Fiscal Year Prospectus Threshold

The following are examples illustrating how SLAs increased space for non-prospectus level leases beyond prospectus thresholds:

- A lease for approximately 70,000 rentable square feet (RSF) with a net annual rent of about \$2 million was awarded in January 2002 with an occupancy start date in November 2002. Two separate SLAs were awarded, both of which resulted in the net annual rent exceeding the applicable fiscal year prospectus threshold. The first SLA, to increase the tenant improvement allowance⁶, was awarded prior to June 2002. This action resulted in a new net annual rent of \$2.15 million, which was above the FY 2002 prospectus threshold of \$2.13 million. An additional 15,744 RSF (23 percent increase) was awarded via SLA in November 2002. The additional space resulted in a net annual rent of approximately \$2.64 million (19 percent above the FY 2003 threshold of \$2.21 million).
- A lease, originally for approximately 67,000 RSF with a net annual rent of about \$1.8 million (within 7 percent of FY 2000 threshold of \$1.93 million), was awarded May 2000 with an occupancy start date in November 2000. An additional 29,622 RSF (44 percent increase) was awarded in December 2000 and resulted in a net annual rent of approximately \$2.82 million (42 percent above the FY 2001 threshold of \$1.99 million). The lease term expires November 2010, or in November 2015 if the 5 year renewal option is exercised.
- A 65,000 RSF lease was awarded in June 2002, with an occupancy start date in February 2003, at a net annual rent of about \$1.55 million. An additional 30,520 RSF (47 percent increase) was awarded via SLA in December 2003, increasing the net annual rent to approximately \$2.3 million, which was above the FY 2004 prospectus threshold.

⁶ The tenant improvement allowance is funded by the lessor for initial space alterations required to raise space from a base building to a finished, usable condition including the special items necessary to customize the space for a particular agency. These costs are amortized over the term of the lease and are included in the net annual rent.

Supplemental Lease Agreements Increased Space for Prospectus Level Lease Parameters Beyond Approved Prospectus Parameters

As part of our review, we compared the approved prospectus to the lease awarded to meet the need identified in the prospectus. During this analysis, we did not identify any instances where the initial leases exceeded the terms set forth in the prospectus. This was a lengthy process, since neither National Office nor the Regions maintained a system for tracking the prospectus to the accompanying lease. As a result, the Regions had to research each prospectus to identify the corresponding lease. During this research, one Region identified a lease that apparently exceeded the prospectus parameters.

However, our review did identify SLAs that increased space for prospectus level leases beyond approved prospectus parameters. These SLAs were awarded over two years after the initial lease award. For example, an additional 53,000 RSF was acquired via multiple SLAs between two to three years after the original prospectus level lease. These SLAs resulted in a total square footage that was 26 percent higher than the approved prospectus square footage.

SLA Requirements Require Proactive Monitoring, but Also Need Additional Clarification

The examples above support the need for more proactive monitoring of non-prospectus leases to ensure that leasing actions (SLAs) will not push leases beyond the applicable prospectus thresholds. Prospectus leases should be monitored as well to ensure that SLAs will not push leases with approved prospectuses beyond the parameters granted in the prospectus for both dollar and RSF amounts. Even with the October 2007 guidance, we noted Regional concerns regarding how to process new space requests using SLAs. This indicates that National Office and the Regions need to communicate about significant changes. National Office can then advise if Congress should be informed and whether an amended or new prospectus should be prepared.

PBS Needs to Address Situations Where Multiple Leases Might be Construed as a Single Leasing Action

Our sample included several instances where multiple leases for a single tenant agency were awarded to co-locate multiple agency components in the same building with similar award and effective dates. The Region viewed these leases as being individual leasing actions based on separate and distinct tenant agency space requests. However, given the similarity and timing of the agency space requests, consideration should have been given to preparing a prospectus for these leasing actions. The prospectus process provides the Congressional oversight committees, and OMB, advance notice of significant leasing actions.

In each of the examples below, one or more of the co-located leases were awarded through the Advanced Acquisition Program.⁷ AAP is used in only one GSA Region, and was originally intended to satisfy customer needs for smaller blocks of space and expedite lease acquisitions. However, AAP has become a major delivery vehicle for virtually all categories of leased space in this particular Region. This Region notes that AAP is not suitable for acquisition of prospectus level leases. Yet our review disclosed that at least five prospectus level leases were awarded using AAP. These leases had annual rents ranging from \$2.8 to \$9.4 million per year. The AAP may have facilitated the situations outlined below.

Non-prospectus Leases, when Combined, are Above Fiscal Year Prospectus Threshold

The following examples illustrate separately awarded leases that possibly should have been integrated under one prospectus level lease.

- Two leases were awarded in the same location with the same tenant agency, similar space requests and the same lease term (expiring in August 2015). The requests were for different components within the agency which were formerly co-located. The file did contain two space requests. However, they were from the same agency contact person, were dated the same day, and each requested about 50,000 RSF. Both leases were awarded on the same day, with the same lease terms, for about 57,000 RSF each. Both leases also contained a 9.42 month rent abatement provision. The combined leases total approximately 114,000 RSF with a net annual rent of slightly over \$3 million (27 percent above the FY 2005 threshold of \$2.36 million).
- Two leases were awarded in the same location for the same tenant agency and lease term. The leases were for about 33,000 and 50,000 RSF, and were awarded on the same day with the same lease effective dates. The combined leases totaled approximately 83,000 RSF with a net annual rent of \$3.13 million (37 percent above the FY 2004 threshold of \$2.29 million). Subsequent SLAs increased the combined square footage to over 90,000 RSF. Both leases will expire in FY 2009. A prospectus was approved in FY 2007 for a combined space procurement that proposes a maximum of 97,049 RSF.
- Four leases were awarded in December 2001 for the same location, with the same tenant agency, and the same lease term. The four lease awards were for approximately 57,000, 44,000, 34,000, and 38,000 RSF. They were awarded on the same day with the same effective dates. The original space requirements could not be located; however, we did see a memo dated November 09, 2001 explaining “Agency X hereby submits the Occupancy Agreements (4) for 150,000 usable square feet at...”⁸ The combined leases

⁷ AAP provides for fast track, multiple award procurements for non-prospectus actions based on a generic solicitation for offers (SFO). The Region develops its AAP lease inventory by advertising, marketing, soliciting and negotiating rental rates for (1) a range of square footages; (2) specific geographic areas; and (3) varied lease terms. Property owners who respond to an advertisement are solicited and their offers are evaluated by the government and placed in a non-binding AAP inventory master file of properties available to satisfy future space needs. The AAP SFO re-opens quarterly to solicit new offers and to allow existing offerors to modify their pricing.

⁸ An occupancy agreement is the term of agreement between GSA and the tenant agency.

total around 173,000 RSF with a net annual rent of \$4.34 million (104 percent above the FY 2002 threshold of \$2.13 million). These leases expire in October 2012.

The commonalities in these examples indicate that the Region should have considered awarding single, rather than multiple leases, with the appropriate prospectus. Not only would such a prospectus provide OMB and the Congressional committees insights on the extent of the leasing actions occurring in the buildings on the same date, it may have provided additional leverage when negotiating the lease terms. Lease administration may also have been more efficient with oversight of only one lease as opposed to multiple leases.

Prospectus Lease, when Combined with Additional Leases, Exceeds Prospectus Parameters

We also observed instances where a prospectus level lease and another lease were awarded for the same location, for the same tenant agency, with the same or similar lease terms.

- A prospectus was approved in November 2001 for 97,000 RSF and maximum rent of \$4.37 million. The lease was awarded for 97,000 RSF in September 2002 with an occupancy start date in August 2003. An additional lease was awarded on the same day, for the same location, for the same tenant agency with a similar lease term. The additional need for space was referenced in a memo in June 2002 stating that the agency “has a minimum requirement to consolidate these employees at one location”. The combined leases totaled approximately 134,000 RSF (essentially the entire building), with a total annual rent of about \$5.7 million (38 percent above the above the approved prospectus maximum rentable square feet and 30 percent above the maximum annual rent). These leases expire in 2013.
- A prospectus level lease was awarded in December 2000 for a 10 year term beginning in January 2003. The lease was for 178,450 RSF with an annual rent of \$4,652,032. This was within the approved prospectus parameters of 178,789 RSF and \$4,827,303. A second lease, for 500 parking spaces at a cost of about \$379,000 annually, was awarded the same day for a ten year term beginning and ending simultaneously with the leased office space. The prospectus only referenced 15 parking spaces. The additional lease for parking spaces, when combined with the initial office lease, would have exceeded the prospectus parameters for parking.
- A prospectus was approved in July 2003 for 149,087 RSF and maximum rent of \$5.07 million. The lease was awarded for 148,099 RSF in August 2004 with effective dates of August 2004 through August 2014. The tenant requested approximately 26,000 RSF of additional space in December 2003 and another 1,200 RSF in March 2004. A separate lease for the 27,000 RSF was awarded in October 2004, although this lease had the same August 2004 through August 2014 effective dates. The combined leases would have totaled around 175,000 RSF with a total annual rent of about \$4.43 million (18 percent above the above the approved prospectus maximum rentable square feet, but under the maximum annual rent).

The AAP was used to award the additional leased office space for all of the above examples, thus providing the opportunity for PBS to co-locate the tenants. One of the benefits of the AAP program is that leasing actions can be expedited as potential properties have already been identified and are available to quickly procure the space. In the instances above, timeliness was stressed in some of the agency space requests and obtaining or amending a prospectus may have increased the time to award the lease.

The above noted similarities in these individually awarded leases indicate that it may have been more prudent to combine them into single leases. If executed as single leases, a new or amended prospectus would have been required prior to award. In circumstances such as those outlined above, the Regions should contact National Office for case-by-case guidance.

Unique Transactions Impacted Prospectus Evaluations

During the course of our review we encountered several distinctive situations where a prospectus might have been sought, or amended, but was not.

Two Prospectuses Combined to Establish Leasing Authority (Blended Prospectuses)

The Region cited two separate prospectuses as the authority for the procurement of a single lease. One prospectus was approved in November 1999 for 140,370 RSF at a maximum rate of \$29/RSF (escalated to \$30.35 in 2002) and the other was approved in September 2000 for 170,459 RSF at a maximum rate of \$32/RSF (escalated to \$32.67 in 2002). Both prospectuses were for the same tenant agency for operations that were located in separate buildings in the same office complex. The blended prospectus calculation combined for a maximum of 310,829 RSF at a rate of \$31.62/RSF. During the solicitation phase, it was recommended that the lease be awarded to the existing lessor because it was the best solution based on the requirements and a Justification for Other Than Full and Open Competition was prepared. The lessor's final offer was based on stepped rents which increased sharply over the life of the lease. The Region calculated a levelized rent rate of \$31.61/RSF for the space which was eventually located in a third building in the same office complex as the preceding two leases. However, the calculated rate exceeded the escalated authorized prospectus parameter (\$30.35) for the November 1999 prospectus. The 10 year lease term expires in September 2012.

Free Rent Used to Lower the Prospectus Calculation

A non-prospectus level lease was awarded that included eight days free rent. The prospectus calculation included in the lease file showed the annual net rent as \$2,209,630, which was \$370 below the FY 2003 threshold of \$2.21 million. (During our review, the Region provided another calculation of the net annual rent for this lease with a slightly different number of \$2,209,055). The October 2007 guidance requires a prospectus for leases with a net annual rent within 10 percent of the yearly threshold. So, under the current requirements, the free rent would not have precluded the need for a prospectus.

Lease Extension Appears to Exceed Approved Prospectus Parameters

A 10-year prospectus level lease was awarded in February 1997. A new prospectus was approved in November 2004 for the expiring original lease (August 2006) with parameters of 163,664 RSF and \$7.36 million. An SLA was awarded in August 2006 to extend the previously occupied space of 158,820 RSF through August 2009. Another SLA was awarded the same day for an additional 9,338 RSF. The lease then totaled 168,158 RSF, with an annual rent of \$7.68 million. If the lease awarded to meet the prospectus requirements has the same square footage as the extended lease, the prospectus lease will exceed the approved prospectus parameters.

The occurrence of these types of issues illustrates the complexity of the prospectus process and the need to enhance guidance, or seek additional clarification from National Office, to address unique situations such as the ones noted. It also indicates a heightened need to evaluate the implications of each leasing action.

Additional Control Issues

Prospectus Analysis Contained Miscalculations

During our review, we noticed instances where prospectus calculations were performed incorrectly. While these particular miscalculations did not have prospectus implications, in projects near the prospectus threshold, miscalculations could have a prospectus impact.

- In the prospectus analysis for two leases, the Region subtracted real estate taxes when calculating net annual rent. Neither of these leases would have been over the prospectus threshold even if correctly calculated. However, prior to our review, PBS did identify a lease calculation in which real estate taxes were deducted in the original net rent calculation. The corrected net rent brought the non-prospectus lease to a prospectus level lease and PBS had to obtain a prospectus to rescue the procurement.
- In one lease, an incorrect operating cost figure was used in the net annual rent analysis.

A confirmation of leasing authority, which includes a calculation of prospectus sufficiency and a reviewer's signature, was cited by one Region as an internal control. However, as noted above, we identified miscalculations in net rent computations and received two different net rent calculations for a single lease. As these examples show, although the control mechanism was in place, it is imperative that the correct calculation method is used and accurately verified. In response to our review, one Region developed a comprehensive standardized template for calculating leveled net rent. The use of standardized templates, with appropriate review, could reduce the risk of miscalculations and strengthen the internal control.

Limited Documentation on Tenant Space Requirements

During our field work, we attempted to identify when the tenant agency initially requested the original or additional space. The official lease file often contained limited formal documentation of tenant agency requirements. GSA removed the requirement for the tenant agencies to submit

a standardized form to officially request space several years ago. PBS's Customer Service Guide to Real Property notes that tenant agencies can now make space requests informally, including via telephone. While flexibility is inherent to the lease process, tenant requirements should be sufficiently formalized to avoid ambiguities in lease requirements and facilitate another Realty Specialist handling a project should there be a need to do so.

Leases not Normally Monitored for Prospectus Compliance after Award

Discussions with National Office and Regional personnel, and accompanying lease file reviews, indicate that after award there is little monitoring of the lease to determine whether it continues to remain within the bounds of the prospectus parameters. During the course of our review we identified several instances where adjustments to leases caused them to exceed prospectus thresholds and parameters. These adjustments were not always recognized by cognizant Regional and National Office staff as affecting prospectus. Additionally, the Regional staff experienced some difficulty linking prospectuses to the accompanying leases. For example, even after considerable research, one Region provided several incorrect prospectus-lease combinations. These issues indicate a need for developing a system for post-award tracking of prospectuses and their accompanying leases. This would ensure prospectus leases remain within approved boundaries and allow for easy identification of associated leases. During our review, one Region developed a project tracking database which included detailed lease and prospectus information.

Communication and Guidance Clarification

The October 31, 2007 memorandum transmitting the updated lease prospectus guidance to the Regions notes that the guidance supersedes certain documents on the Capital Allocation website (PVAB). However, the former guidance was not updated or labeled as superseded on this website at the time of issuance. During our review, one Region proactively updated its Regional control documents, inadvertently using the superseded guidance on the PVAB website. We noticed this discrepancy and informed the Region, so it could base its revisions on the current policy. As of February 2009, the former guidance was still posted on the PVAB website.

Given the complexities in the lease prospectus process, communication between National Office and the Regions is extremely important in making sure the proper procedures and regulations are being followed. The review indicated that the Regions communicated with National Office for guidance and clarification of certain unique situations. Alternatively, we also identified decisions made at a Regional level that perhaps could have benefited from a National Office perspective. Enhancing communication efforts between the tenant agency and the Regions, and between the Regions and National Office, would strengthen the efficiency and integrity of the lease prospectus process.

CONCLUSION

Many factors complicate the prospectus process. Regional officials noted that obtaining timely customer requirements can be problematic, stating the requirements are often unclear or

incomplete. Also, the tenant agency may have to adjust its space requirements due to changing conditions that surface long after the initial space request.

Regions are doing a creditable job of developing and submitting prospectus packages; however, we did identify areas in the prospectus process that need improvement. Whether through inconsistent interpretation of requirements, a lack of oversight, or insufficient communication, some leases that possibly required prospectus approval or amended approval did not receive it. The updated National Office guidelines and recent Regional controls are a good step toward improving the prospectus process. However, the Regions need a uniform approach to evaluating leasing actions relative to prospectus issues. Additionally, a more proactive approach needs to be taken to prevent violations from occurring in the first place.

In general, there were variances in the Regions regarding how to process additional space requests from the tenant agency and inconsistencies in defining what constitutes a separate and distinct leasing action; a topic not covered in current policy. PBS should evaluate the circumstances and current status of the leases cited in this report to determine if additional reporting to Congress is required on these transactions to meet the intent and integrity of the lease prospectus process.⁹

When we discussed the results of our review with Regional officials, they indicated they would have handled certain past leasing actions differently had the updated National Office guidance been in place. The Regions have also initiated additional internal controls since the award date of many of the leases in our sample. These controls, as well as clarifications in the updated guidance, may preclude many of the issues identified during our review. It should be noted that approximately 83 percent of the problems identified during our review were linked to one Region. This Region also represents approximately 77 percent of the audit sample.

RECOMMENDATIONS

We recommend that the Commissioner of the Public Buildings Service:

1. Establish a consistent approach for evaluating leasing actions for prospectus compliance, especially for additional space requests, SLAs and rent calculations;
2. Improve communication and coordination among the prospectus process participants;
3. Review the examples cited in our report to evaluate the current status of the leases and determine whether any leasing actions need to be reported to the appropriate Congressional committees;
4. Develop controls to monitor prospectus leases after award; and
5. Remove superseded prospectus guidance from PBS's internal websites or identify it as having been superseded.

⁹ The lease and prospectus numbers corresponding to the examples in this report have previously been provided to Regional and National Office officials.

MANAGEMENT COMMENTS

Management agreed with four (1, 2, 4, and 5) of the report's five recommendations. For recommendation number 3, PBS's response indicates that PBS has completed the actions contained in the recommendation. PBS has reviewed the examples cited in our report and made the determination that, given the timing of the leases, the leasing actions contained in the report do not require immediate Congressional notification. PBS also commented "where lease renewal is anticipated in a future fiscal year for leases cited in your report, the prospectus submitted will address any unresolved issues that need to be brought to the attention of our authorizing committees." The Acting PBS Commissioner's comments are included in their entirety in Appendix A of this report.

INTERNAL CONTROLS

We evaluated the internal controls relating to the prospectus program that were appropriate to meet the objectives of this audit. Relevant internal controls issues are discussed in the context of the review findings. We did note, however, that sampled Regions used a variety of controls to evaluate leases for prospectus compliance. These include established PBS controls such as monitoring Budget Activity 53 (Rental of Space), as well as customized Regional controls which require the completion of templates, forms, calculations and checklists specific to the prospectus process.

APPENDIX A: MANAGEMENT COMMENTS



GSA Public Buildings Service

JUN 30 2009

MEMORANDUM FOR R. NICHOLAS GOCO
DEPUTY ASSISTANT INSPECTOR GENERAL
FOR REAL PROPERTY AUDITS - JA-R

FROM: ANTHONY E. COSTA
ACTING COMMISSIONER - P

SUBJECT: Draft Report: Review of Management Controls over the Lease
Prospectus Process, Report Number A070199

The Public Buildings Service appreciates the opportunity to review and comment on the draft report, "Review of Management Controls over the Lease Prospectus Process" (A070199). In an effort to ensure that our leasing transactions adhere to prospectus requirements defined by Title 40, United States Code, Section 3307, the Offices of Portfolio Management and Real Estate Acquisition have reviewed the Office of Inspector General's draft report and offer the attached responses to the report's recommendations.

Should you have any questions, please contact me at (202) 501-1100.

Attachment

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

**Office of Inspector General (OIG) Draft Report
"REVIEW OF MANAGEMENT CONTROLS
OVER THE LEASE PROSPECTUS PROCESS"
REPORT NUMBER A070199
May 14, 2009
General Services Administration
Public Buildings Service**

Office of Inspector General's Recommendations:

1. Establish a consistent approach for evaluating leasing actions for prospectus compliance, especially for additional space requests, SLAs, and rent calculations.
2. Improve communication and coordination among the prospectus process participants.
3. Review the examples cited in our report to evaluate the current status of the leases and determine whether any leasing actions need to be reported to the appropriate Congressional committees.
4. Develop controls to monitor prospectus leases after award.
5. Remove superseded prospectus guidance from PBS's internal websites or identify it as having been superseded.

PBS's Response:

Recommendations 1 and 2:

PBS agrees with these recommendations. We will develop and issue a policy statement for lease prospectus compliance and encourage consistent practices that eliminate policy ambiguities and foster communication and coordination across business lines.

Recommendation 3:

PBS has reviewed the examples cited in the report and does not believe that any of the leasing actions require congressional notification at this time. Most of the examples cited are sufficiently remote in time that the relevance of notification would be significantly diminished. In any case, where lease renewal is anticipated in a future fiscal year for leases cited in your report, the prospectus submitted will address any unresolved issues that need to be brought to the attention of our authorizing committees. PBS has successfully used this approach in prior prospectus submissions where it was essential to advise its committees of past procurement irregularities in relation to prospectus requirements.

- 2 -

Recommendation 4:

PBS agrees with this recommendation. We will implement additional management controls for monitoring prospectus leases after award.

Recommendation 5:

PBS agrees with this recommendation. We have begun by reviewing the content of the Office of Portfolio Management website and removing superseded lease prospectus guidance. We will continue to monitor this website and will also initiate the review of the content of other PBS internal websites for any additional changes that may be required.

APPENDIX B: REPORT DISTRIBUTION

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Assistant Inspector General for Investigations (JI).....	1
Director, Internal Control & Audit Division (BEI)	1