Office of Audits
Office of Inspector General
U.S. General Services Administration

Audit of PBS's Planning and Funding for Exchange Projects

Report Number A160024/P/R/R17004
March 30, 2017

Executive Summary

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Why We Performed This Audit

Due to funding constraints, GSA has increased its use of real property exchanges in recent years to assist in meeting its capital improvement needs. We performed this audit to determine if PBS is conducting exchanges in accordance with Agency guidance and federal exchange authorities.

What We Found

PBS's planning and reporting for exchange projects has not been comprehensive. We found that, while certain PBS exchange guidance mentions potential risks, PBS did not adequately factor risk into its financial analyses, causing it to overvalue its properties. As a result, PBS cancelled or did not pursue four exchange projects. Contrary to its exchange guidance, PBS also did not always identify, plan for, and report the additional funding that exchanges might require, leaving itself at risk for funding shortages or using operational funds to meet capital project needs. Additionally, PBS's guidance is outdated and does not encompass many aspects of the exchange process. Specifically, the guidance does not address how PBS will fund change orders or shortages, nor does it address how cash equalization payments will be handled.

What We Recommend

PBS should improve its exchange process to better maximize its resources. PBS should develop improved and comprehensive guidance that requires it to identify and quantify risk in the planning process. Additionally, PBS should increase transparency in the quarterly exchange reports it submits to congressional appropriations committees. Improving risk assessments, the planning process, and exchange guidance will help PBS make the best decision for GSA, its tenants, and the taxpayer when considering whether to exchange, dispose of, or retain its property. Consequently, we recommend that PBS adequately quantify risk in the decision-making process and throughout the exchange, identify and plan for support costs, inform congressional appropriations committees of the support costs for exchanges, and update its exchange guidance. In its response, PBS agreed with our recommendations (***Appendix C***).

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Introduction

We performed an audit of PBS's real property exchanges, focusing on the supplemental funding of these projects.

Purpose

We performed this audit because of GSA's increased use of its exchange authorities in recent years. With limited funds available for capital projects, GSA has expanded its use of exchanges to help meet its capital improvement needs. We noted concerns with GSA's exchange program as part of our fiscal years 2016 and 2017 *Assessment of GSA's Major Management Challenges*.

Objective

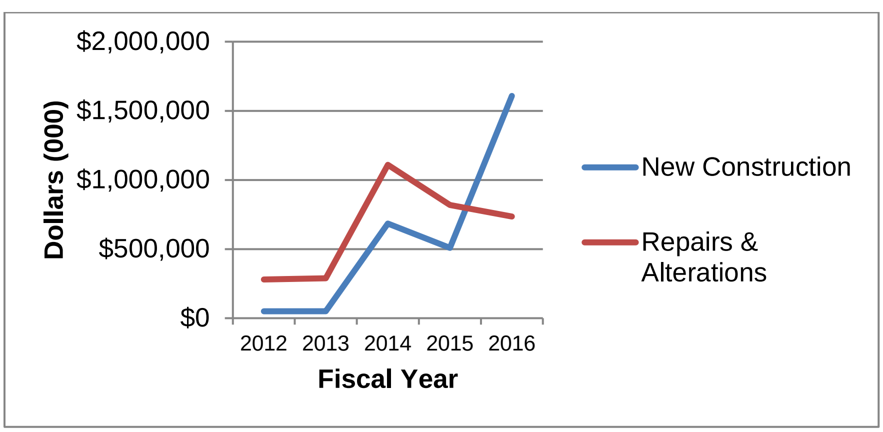
The objective of our audit was to determine if PBS is conducting real property exchanges in accordance with Agency guidance and federal exchange authorities.

See ***Appendix A*** – Scope and Methodology for additional details.

Background

GSA's PBS is the landlord for the federal government, providing federal agencies with the real property needed to accomplish their missions. In 2016, PBS reported that its owned inventory has an average age of 49 years and that needed repairs and alterations have been repeatedly deferred due to funding constraints. PBS estimates that the total cost of deferred maintenance and repairs and alterations, defined as work that needs to be performed immediately to restore or maintain acceptable building conditions, is $1.2 billion. In recent years, PBS has faced funding constraints as congressional appropriations for new construction and repairs and alterations have varied (see *Figure 1*).

Figure 1 - Congressional Appropriations



Consequently, GSA has actively explored the use of real property exchanges to meet its needs for constructing new buildings and renovating its existing real property. GSA has the authority to exchange property for new construction, existing property, and construction services on properties in its inventory. Real property exchanges have the potential to provide multiple benefits to GSA, including:

- Transferring underutilized properties out of GSA's inventory, thus generating savings by eliminating related maintenance, operations, and security costs; and
- Applying the value of the federal property being exchanged to finance construction needs, rather than waiting for the funds to be made available through an annual congressional appropriation.

In response to requests from congressional appropriations committees, GSA submits quarterly reports to the House and Senate Appropriations Committees describing all exchanges that occurred in the previous quarter and those planned for the future, including the costs, risks, and benefits of each.

GSA can use several authorities to exchange federal real property.[1] GSA's original exchange authority, codified at 40 U.S. Code (USC) 581 (c), states that "The Administrator may acquire, by purchase, condemnation, or otherwise, real estate or interests in real estate." GSA's Office of General Counsel determined that this provision authorizes the Administrator to acquire real property by exchange. Additional authority, codified at 40 USC 3304, states that "The Administrator may acquire, by purchase, condemnation, donation, exchange, or otherwise, any building and its site…." In addition, Section 412 of the GSA General Provisions, Consolidated Appropriations Act 2005, Public Law 108-447 (Section 412) authorizes GSA to exchange its real property for construction services.

Section 412 states:

> Notwithstanding any other provision of law, the Administrator of General Services may convey, by sale, lease, exchange or otherwise, including through leaseback arrangements, real and related personal property, or interests therein, and retain the net proceeds of such dispositions in an account within the Federal Buildings Fund to be used for the General Services Administration's real property capital needs: *Provided,* That all net proceeds realized under this section shall only be expended as authorized in annual appropriations Acts: *Provided further,* That for the purposes of this section, the term "net proceeds" means the rental and other sums received less the costs of the disposition, and the term "real property capital needs" means any expenses necessary and incident to the agency's real property capital acquisitions, improvements, and dispositions.

[1] These GSA exchange authorities originated in the Federal Property and Administrative Services Act of 1949 (40 USC 581 (c)) and the Public Buildings Act of 1959 (40 USC 3304).

In addition to the explicit authorities contained in Section 412, PBS has interpreted the Section to authorize GSA to accept in-kind consideration for real property exchanges, including design and construction services for the renovation of property or new construction of a replacement building.

PBS established policies and procedures for real property exchanges in 1997, with the issuance of *Guidance for Real Property Exchanges on Non-Excess Property* (1997 Exchange Guidance). The 1997 Exchange Guidance requires PBS to:

- Estimate the value of the property involved and document the basis for that valuation;
- Estimate all costs the government will incur to complete the exchange;
- Obtain a third party appraisal for all properties involved; and
- Complete a cost/benefit analysis for the exchange.

As a result of our November 12, 2013, audit memorandum, *PBS Needs to Develop Policies and Procedures for Use of Section 412 Authorities*, PBS issued guidance in 2014 establishing procedures specifically governing Section 412 exchanges. GSA Policy and Procedure PBS P 4065.1, *Procedural Guidance for Section 412 Exchanges for In-Kind Consideration* (Section 412 Guidance) provides that:

- Regions must notify the Portfolio Division of potential exchanges and have a National Project Manager assigned to assist the region with the exchange;
- Additional funding for the exchanges, such as for site acquisition; environmental, engineering, and title studies; and change orders must be coordinated through the National Project Manager to identify funding sources and gain approval;
- Regions must prepare a business case analysis to assess the feasibility of the exchange and should include an evaluation of the standard options for the property (retention, disposal, or exchange) as well as a comparative analysis of the values of the property to be exchanged and the property or services to be received; and
- The Administrator must approve the region's business case prior to issuing a Request for Information to determine public interest in the potential exchange.

To date, PBS has completed eight exchanges, with the highest value exchanged property worth $10.8 million.[2] Five of these completed exchanges were under $3 million. All of these completed exchanges were negotiated with a single party, generally a state or local public agency. None used the Section 412 authority.

In recent years PBS has begun pursuing competitive exchanges, in which PBS issues a solicitation to the private sector to obtain competitive proposals for the property. When

[2] PBS included the Charles R. Jonas Federal Building and Courthouse in Charlotte, North Carolina, exchange on a list of nine completed exchanges, since the exchange agreement was signed in March 2016. We do not consider this exchange as completed since the properties in the exchange will not be conveyed until the roof replacement required by the exchange agreement is completed. The City of Charlotte selected a roof replacement contractor in November 2016.

we selected our audit sample in November 2015, we included all eight exchanges that PBS had in process. Six of these eight potential exchanges were competitive; three of the six were under the Section 412 authority. The estimated values of seven of the eight exchanges in our audit sample were significantly higher than $10.8 million (the value of the largest exchange PBS has completed to date).

As PBS project teams pursued competitive exchanges, they learned that developers place lower values on federal properties than the PBS teams had anticipated. In 2016, PBS cancelled or chose not to pursue four of the eight exchanges in process: the Auburn Federal Complex in Auburn, Washington (Auburn exchange); undeveloped land in Lakewood, Colorado (Lakewood exchange); the State Street buildings in Chicago, Illinois (State Street exchange); and the Federal Triangle South project in Washington, D.C. (Federal Triangle exchange). PBS cancelled the State Street and Federal Triangle exchanges because the developers' offers did not meet PBS's anticipated value for its properties. Based on the lessons learned from these projects, PBS decided not to move forward with the Auburn and Lakewood exchanges. PBS will instead pursue the traditional disposal process for all or portions of the properties involved in these four exchanges.

PBS is still working on large-scale property exchanges, including the Federal Bureau of Investigation Headquarters Consolidation (FBI exchange). However, PBS has significantly revised the financial structure of the FBI exchange since issuing the Phase I Request for Proposals in December 2014. In particular, the value of the property to be exchanged (the J. Edgar Hoover building) is no longer the sole funding source for the new headquarters. The FBI and GSA received $390 million in appropriations in fiscal year 2016 and have requested an additional $1.4 billion in appropriated funds for fiscal year 2017 to complete the exchange.

PBS is also moving forward with the John A. Volpe National Transportation Systems Center exchange in Cambridge, Massachusetts (Volpe exchange). The Volpe exchange's anticipated timeline spans several years with anticipated construction of approximately 400,000 square feet of federal space for the Department of Transportation.

We also reviewed a negotiated exchange with the City of Charlotte, North Carolina, involving the Charles R. Jonas Federal Building and Courthouse (Jonas exchange) and the exchange of a federally-owned motor pool property in Salt Lake City, Utah, for construction services (Salt Lake City exchange). See ***Appendix B*** for additional details on all eight exchanges we reviewed.

Results

PBS has been pursuing real property exchanges as an option for managing its real property portfolio. Exchanges allow PBS to remove underutilized properties from its inventory while addressing other real property needs. Exchanges also have the potential to help PBS dispose of unneeded real property, acquire new property, and maintain and improve its other properties.

However, PBS's planning and reporting for exchange projects has not been comprehensive. PBS's exchange guidance does not consider how risk will affect the value GSA might receive for its properties in an exchange. Specifically, we found that PBS did not adequately factor risk into its financial analyses, causing it to overvalue its properties and ultimately cancel or not pursue some exchange projects. Also, contrary to its exchange guidance, PBS did not identify and plan for the additional funding that exchanges might require, leaving itself at risk for funding shortages or using operational funds to meet capital project needs. In addition, PBS's guidance does not encompass many aspects of the current exchange process, especially the funding of change orders and shortfalls. Finally, PBS costs related to exchanges are not fully transparent in the quarterly exchange reports it submits to congressional appropriations committees. Strengthening these areas will assist PBS in executing real property exchanges that are in the best interest of the government and the taxpayer.

Finding 1 – PBS did not fully factor risk into its planning for exchange projects and as a result, cancelled or chose not to pursue several exchange projects.

PBS's current guidance, the 1997 Exchange Guidance and Section 412 Guidance, does not require it to quantify risk, nor does it address discounting property values to account for the time the developer will have to wait to realize a return on its investment in exchanges. In exchanges involving construction services, the developer must complete the construction services before receiving the government's property as consideration. Depending on the extent of the construction services, this may take several years. As a result, developers discount the value of PBS's properties to account for investment risk. While PBS was conceptually aware of this risk, it did not fully factor the risk into its initial decisions to pursue exchanges or into the value it expected to receive for its properties from developers. As a result, PBS spent significant funds and time on multiple exchange projects that it ultimately cancelled or chose not to pursue.

Based on our audit fieldwork, we conclude that a decision to pursue an exchange project should be based on a comprehensive financial analysis or business case that includes an evaluation of how risk might affect the values that developers are willing to propose for GSA's properties. This analysis should be conducted before GSA expends significant resources on the project. However, neither the 1997 Exchange Guidance nor the Section 412 Guidance requires PBS to quantify risk. PBS's 1997 Exchange Guidance, governing all exchanges besides Section 412 exchanges, does not address risk at all. It does not require a financial analysis or business case during the planning phase of a project. It only requires a cost/benefit analysis of exchanging GSA property when the exchange is near completion. Likewise, while PBS's Section 412 Guidance requires a business case and consideration of risk, it does not require risk to be quantified. The guidance requires business cases to include a comprehensive financial analysis that considers the relevant net present values associated with retaining the property as-is, exchanging the property for construction services, or disposing of the property; and how different factors could affect the property's value. The Section 412 Guidance also requires the business case to examine the feasibility of completing an exchange, examine the public interest in acquiring the property through an exchange, and specifically detail the advantages of exchanging the property. However, the guidance does not require the business case to take risk into account.

PBS relied heavily on appraisals to establish the value of its properties. PBS officials noted that appraisals are generally only relevant and reliable for 12 months since they are based on current market conditions. Consequently, PBS obtained multiple appraisals on its properties to ensure the appraised values would be current when compared to developers' offers. However, appraisals do not factor in the extended length of exchange transactions and the time it would take for the developer to receive the property. PBS also did not discount property values in its financial analyses or business cases to account for future market conditions or other risks, such as change order risk, that developers factored into their evaluations.

The following exchange projects in our sample were ultimately cancelled or not pursued as a result of PBS's failure to quantify the risks it identified during the exchange process.

> **Federal Triangle exchange.** PBS originally anticipated receiving Federal Triangle exchange proposals that equaled or exceeded the appraised values of its Regional Office and Cotton Annex buildings and sites. However, developers' proposed values were significantly less than PBS's expectations, leading to the project's cancellation. Developers cited the following risks: construction on a partially occupied building, interest rate risk, timing risk, and zoning risk.
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> In planning for the Federal Triangle exchange, PBS acknowledged the presence of "substantial schedule, financial, technical and operational risk…" and recognized the need to minimize "…risks in a process that is not frequently used to ensure the project is delivered successfully." However, PBS did not discount the expected value of its properties to account for these identified risks.
>
> PBS spent over 3 years and $336,000 for an environmental assessment in pursuing this ultimately cancelled exchange. The Regional Office building remains in PBS's inventory, while PBS pursues a disposal of the Cotton Annex building.[3] While the sale under the disposal process is not final, PBS accepted a

[3] The disposal process requires that the property first be offered to other federal agencies. If another federal agency does not identify a need for the property it is then made available for homeless use, public benefit conveyance, and negotiated sale to a state or local government, in that order. If the property is still available after exploration of those options, GSA can then sell the property to the public.

bid on the Cotton Annex in February 2017. In the time that PBS spent planning for the exchange, PBS spent over $360,000 on maintenance and security costs for the Cotton Annex building, costs that could have been avoided had PBS disposed of the building.

State Street exchange. Early on, a developer (who ultimately did not submit a bid on the project) cited the length of the development process and the timing of the property acquisition as project risks. Specifically, the developer stated in its response to the July 2014 Request for Information, "Time is the enemy of this project due to the complexities/uncertainty/speed of what can be developed and the remaining length of the current favorable real estate cycle." Despite this feedback, PBS did not adjust the properties' value to account for the risks associated with the transaction during its planning.

PBS received two developer proposals on the State Street exchange, only one of which met the minimum requirements in the Request for Proposals. The sole responsive developer, according to PBS officials, subsequently pulled out of the project because it "was having trouble making the numbers work." In correspondence with PBS, the developer stated this was "…due to site inefficiencies and a sizable façade restoration budget, coupled with a softer market and less liquid debt market…."

In February 2016, PBS cancelled the State Street exchange. PBS correspondence notes that staff worked on the project for 3 to 4 years. In addition to the staff time spent on the project, PBS spent approximately $127,000 in support costs for building appraisals, an environmental safety inspection, and developing the construction specifications. PBS has since decided to dispose of the properties. During the 4 years prior to cancelling the exchange, PBS spent $1.1 million in maintenance costs for the four buildings. PBS may have avoided much of these maintenance costs had it decided to dispose of the buildings earlier.

Auburn and Lakewood exchanges. In April 2016, PBS informed us that, because of lessons learned on the Federal Triangle and State Street exchanges, it was not pursuing the Auburn and Lakewood exchanges. While neither project had reached the Request for Proposals stage, both projects had incurred support costs and employee time. PBS spent approximately 10 months and $236,000 in support costs on the Auburn exchange and over 2 years and approximately $904,000 in support costs on the Lakewood exchange.

PBS performed a risk assessment on the Auburn exchange and recognized risks associated with the Lakewood exchange, including the project's long timeframe. Although PBS identified risks on the Auburn and Lakewood exchanges, it did not discount the properties' values when performing the comprehensive financial analysis involved in deciding whether to exchange, dispose of, or retain the properties. PBS has since recommended disposal of all or portions of both properties.

In both the exchange and disposal options, PBS establishes an anticipated value for what it will receive. PBS has been more successful in receiving its anticipated fair market value when using the disposal process than when using the exchange process. Between 2012 and 2015, PBS used its disposal authority to sell 21 properties either by negotiation or on-line auctions. In total, PBS received 71 percent more than the estimated fair market value of these properties. This reinforces the importance of fully evaluating the risk associated with each option in the business case and discounting property values accordingly.

PBS-Developed Risk Mitigation Strategies

Based on lessons learned from previous exchanges, PBS developed several strategies to reduce risk in exchange projects. These strategies include:

1. *Risk Analysis* – During the course of our audit, PBS developed a "20-Year Cash Flow Analysis" that allows it to value the exchange properties based on the developer's possible assumptions. PBS can adjust the model for each individual project to accommodate various levels of risk. So far PBS has used the model on only the Volpe exchange, which is currently ongoing. PBS plans to use the model on the FBI exchange as well. PBS developed the model after cancelling or deciding not to pursue the four exchanges discussed previously.
2. *"Draft" Request for Proposals* – PBS issued a "draft" Request for Proposals for the Volpe exchange asking offerors to provide input on the exchange agreement. PBS stated the "draft" Request for Proposals allowed developers to provide early information and PBS to refine the terms of the official Request for Proposals to reflect developers' concerns.
3. *Early Access* – PBS has experimented with the option to provide developers access to part of the GSA property being exchanged before construction work is completed. This would allow the developer to recognize a quicker return on investment. For example, the Auburn exchange's draft Request for Qualifications contained a provision allowing the developer early access to the property if risks were mitigated and ongoing operations were not affected. Additionally, if developers at the Volpe exchange want to use portions of the exchange property prior to the completion of construction, they can submit a request for early access to the GSA contracting officer.
4. *Progress Payments* – GSA has significantly revised the financial structure of the FBI exchange to include appropriated funds. This additional funding allows PBS to make progress payments as the exchange partner performs construction on the new FBI Headquarters, allowing for a quicker return on investment and reduction of the exchange partner's risk.

While PBS's strategies to reduce risk are an improvement, their effectiveness is unknown since PBS has not completed any large-scale exchanges using these strategies.[4] During the planning phase of an exchange project, PBS should require a comprehensive and objective financial analysis to determine whether a property should be exchanged, disposed of, or retained as-is. The financial analysis should include identifying and quantifying the risk involved in completing an exchange.

Finding 2 – PBS did not fully identify, plan for, and report the funding for all aspects of exchange projects.

PBS guidance allows appropriated funds to be used to supplement real property exchanges and requires supplemental costs to be considered in planning potential exchanges. Supplemental costs include costs to plan for, manage, and complete an exchange project. However, PBS did not fully identify these exchange project costs in its planning process or its reports to congressional committees.

The exchange process requires GSA to invest considerable resources in planning and negotiating proposed exchanges. Additional resources are also needed to manage ongoing exchange projects, especially those involving construction services. These costs can consist of:

- Planning phase costs, such as environmental studies and remediation expenses, site inspections, engineering studies, and appraisals;
- Direct and indirect costs of PBS personnel and contractors assigned to the project; and
- Project costs, such as construction management, contract modifications, and change orders.

Developing estimates of project planning and oversight costs is essential to PBS's ability to consider those costs when deciding whether to pursue an exchange project. Both the 1997 Exchange Guidance and the Section 412 Guidance recognize that PBS might incur such costs to complete the exchange. GSA's 1997 Exchange Guidance requires PBS to estimate the costs the government will incur to complete the exchange, including appraisals, site cleanup, legal fees, title insurance, and environmental assessments. However, it does not specify that this estimate should be completed in the planning phase, only that it be included in the regional submission to the GSA Administrator for approval to complete the exchange. The Section 412 Guidance requires that PBS consider additional funding as one of the criteria in the selection and approval of the exchange. The guidance requires the business case to include an estimate of the planning phase costs and evaluate the direct and indirect costs of Agency personnel assigned to the project. Section 412 Guidance also recognizes that unforeseen conditions may require supplemental funding and directs the region to incorporate funding contingencies into its project planning and execution.

[4] Since the conclusion of our audit fieldwork, PBS signed the Volpe exchange agreement for $750 million, which is more than the value it expected to receive. Our audit fieldwork confirmed that the Volpe project team used three of the four risk mitigation strategies discussed above.

We found that the business case or other planning documents for six of the eight exchanges we reviewed did not include planning phase or project cost estimates, and none estimated the direct and indirect costs of GSA and contractor personnel assigned to the project. PBS developed cost estimates only for the Volpe and Jonas exchanges. For the Volpe exchange, PBS estimated costs for environmental studies and the development of construction specifications and the statement of work. The budget also noted funds would be provided by the Department of Transportation for appraisal and title review. For the Jonas exchange, PBS presented estimates for the appraisal and feasibility study costs.

Developing project cost estimates would also help PBS ensure that it funds the costs properly. Because exchange projects are not authorized through the budget process, they do not typically receive line item funding for planning and oversight costs. GSA must therefore identify funding sources for such costs.

As of fiscal year 2016, PBS's planning phase costs for the eight exchanges in our sample totaled over $9 million, including approximately $1.6 million for the projects that were cancelled. In addition, PBS incurred costs associated with the time PBS employees and support contractors spent working on exchange projects, including preparing Requests for Information, Decision Papers, Requests for Proposals, and discussing projects with potential developers and stakeholders.

PBS funded these planning phase costs from its Building Operations account. PBS management officials and GSA's Office of General Counsel informed us this is an allowable use of these funds. According to PBS's *Guidance on Proper Building Operations Funding Towards Capital Projects FY 2014*, the Building Operations account is intended to cover the day-to-day operational expenses for GSA's federally-owned and leased facilities, including salaries, utilities, cleaning and maintenance service contracts, security, and repairs and alterations that are less than $25,000. The guidance also allows funds from the Building Operations account to be used for project planning costs such as building engineering reports, environmental studies, historic preservation studies, market surveys, appraisals, and site studies.

PBS had also planned to use Building Operations funds for construction management services. For example, the project executive on the cancelled Federal Triangle exchange estimated the construction management services, to be provided by a contractor, would cost over $15 million, which was to be funded from the Building Operations account. However, while PBS's guidance allows the use of Building Operations funds for in-house project management costs during the construction phase of a project, contractor construction management services are typically funded using appropriated capital project funds, which exchanges usually do not have.[5] Therefore, this may not be a proper use of Building Operations funds.

In addition to not identifying costs in the planning process, PBS did not report these costs to congressional appropriations committees as requested. As noted above, GSA

[5] To date, only the FBI exchange has received appropriated funding.

sends quarterly reports to its congressional appropriations committees on all exchange actions that occurred during the relevant quarter, including the costs, benefits, and risks for each action. We reviewed the eight reports submitted in fiscal years 2015 and 2016 and found that PBS did not include all the supplemental costs necessary to plan for, manage, and complete the reported exchanges. For the FBI exchange, PBS reported partial costs. In the two most recent quarterly reports, PBS included the $75 million dollars it received in appropriated funds for construction management and oversight but did not mention the $6.59 million PBS spent on planning costs from Building Operations funds. For the other ongoing exchanges, PBS did not report any costs.

Further, we observed that PBS removed the Jonas exchange from the quarterly reports after the exchange agreement was signed. However, the contract for the new roof that is part of the Jonas exchange had not been awarded. According to the exchange agreement, GSA will pay the costs for the new roof above an agreed upon level. Hence, the final cost of this exchange to GSA is still to be determined. For larger projects such as Volpe, additional construction costs could be significant and extend several years beyond the date of the exchange agreement. Projects should remain on the quarterly congressional report until all costs have been incurred.

Finding 3 – PBS's exchange guidance does not encompass many aspects of the exchange process, especially the funding of change orders and budget shortfalls and the use of cash equalizations.

Exchange projects are handled inconsistently due to outdated and incomplete guidance. For example, as discussed in *Finding 1*, business case and financial analyses are required during the decision-making phase of Section 412 exchanges, yet are not required for other exchanges that follow the 1997 Exchange Guidance. While each exchange is unique, PBS should have detailed guidance on how certain aspects of all exchanges will be handled. Specifically, both the 1997 Exchange Guidance and Section 412 Guidance should detail how change orders and funding shortages will be funded.

PBS's 1997 Exchange Guidance does not provide specifics on how PBS will fund change orders and funding shortages for exchange projects. However, PBS's Section 412 Guidance states that "The availability of additional funding may impact the selection of the property or services being sought by the Government, and this contingency should be addressed in the business case and exchange agreement with the offeror." The Section 412 Guidance further requires that all funding requests, including change orders, be coordinated through a National Project Manager to determine which account will fund the specific requests. Consequently, PBS is using different methods, outlined below, to manage these situations.

Change Orders and Cash Equalizations

PBS planned to use multiple methods to fund construction change orders in the exchanges in our sample. For three of the eight exchanges we reviewed, PBS project teams required developers to provide a contingency amount, which varied from 5 to 15 percent, to fund change orders. However, for the remaining exchanges, project teams' plans were inconsistent.

For example, the Salt Lake City and the Volpe exchange project teams planned to fund change orders using the cash equalization payment, as the properties being exchanged were estimated to be worth more than the services received in the exchange.[6] Specifically, the Volpe exchange project team said the cash equalization funds would first fund unforeseen site conditions, then would fund options in the Statement of Work, and any remainder would be deposited into the Federal Buildings Fund. The Lakewood draft exchange agreement stated that various scope of work items could be reduced or removed in order to fund PBS authorized changes.

In contrast, the Jonas exchange project team did not address how change orders would be funded; and the State Street exchange project team told us they did not think they could use cash equalization to fund change orders because the cash equalization funds from Section 412 exchanges must be deposited into the Federal Buildings Fund before being used. Instead, the State Street project team planned to use PBS's Basic Repair and Alterations account to fund change orders. However, PBS's Basic Repair and Alterations account, which funds repairs, remodeling, modernizations, and improvements from $25,000 to the prospectus limit of $2.85 million, typically has only limited funding and using these funds for exchanges reduces the amount of funding available to address GSA's repair and alterations backlog.

Change orders are typical on construction projects and PBS should address, early in the decision-making process, how such orders will be funded and under what circumstances GSA, the tenant, or the developer will be responsible for the funding.

Funding Shortages

Since most exchanges do not receive line-item funding, GSA may face funding shortages if the final value of the construction exceeds the value of the exchanged property. While multiple projects cited what would occur if construction costs were less than the value of GSA's property, only three included PBS's plans if there were a funding shortage.

- In its planning for the Volpe exchange, the PBS project team stated that in the event of a funding shortage it would modify construction services for the new facility, consider using tenant funding, or consider what GSA could fund.

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[6] When PBS expects the value of the property being exchanged to exceed the value of construction services it receives, the developer will make up the difference with a cash equalization payment.

- The Jonas exchange agreement requires GSA to pay for excess roof construction costs up to an agreed upon limit. Beyond that amount, GSA is not obligated to pay for excess construction costs.
- The State Street project team structured the construction services so that items were severable should there be a funding shortage.

Change orders and funding shortages are not uncommon on construction projects. Considering the complexity and breadth of PBS's recently pursued exchanges, it should update the 1997 Exchange Guidance and Section 412 Guidance to address both situations. Specifically, the guidance should detail how change orders and shortages can and will be funded and the procedures for handling both occurrences. This will help PBS ensure that exchange projects are properly funded and adhere to consistent practices.

Conclusion

PBS has completed small exchanges, but larger exchanges have proven more problematic due to their complexities and extended timeframes. For the eight exchange projects in process as of November 2015, PBS project teams did not fully factor risk into their financial analyses, causing them to overvalue GSA's properties and cancel or not pursue four of the projects. In particular, PBS officials have learned that developers significantly discount the value offered for government property to account for the risk they assume in an exchange. PBS must factor this risk into its analyses. The exchange process also requires GSA to invest considerable resources, in both employee time and Agency funding, in planning and negotiating proposed exchanges. PBS is not properly planning for the funds needed to support the project or cover funding shortages. PBS is also not reporting support costs in the quarterly exchange reports it submits to congressional appropriations committees. Additionally, PBS's guidance is outdated and does not encompass many aspects of the exchange process.

Recommendations

We recommend that the Acting PBS Commissioner:

1. Update exchange guidance to:
    a. Require financial and business case analyses that fully quantify risk for all potential exchanges when making the decision to exchange, dispose of, or retain a property. If an exchange is pursued, require that PBS continue to quantify risk throughout the project;
    b. Address funding for change orders, support costs, and funding shortages; as well as the use of cash equalization; and
    c. Require PBS to estimate support costs and identify funding sources when planning an exchange.
2. Revise quarterly exchange reports to congressional appropriations committees to:
    a. Include projects through completion, and
    b. Identify support costs.

GSA Comments

In its comments, PBS agreed with our recommendations. PBS's response and its technical comments are included in their entirety in ***Appendix C***.

Office of Inspector General Response

We maintain the positions included in this report. We provide detailed responses to PBS's comments in ***Appendix D***.

Audit Team

This audit was managed out of the Real Property and Finance Audit Office and conducted by the individuals listed below:

Marisa A. Roinestad	Associate Deputy Assistant Inspector General for Auditing
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Appendix A – Scope and Methodology

We reviewed the eight exchanges that PBS was pursuing in November 2015. These exchanges were taking place in the National Capital Region, New England Region, Southeast Sunbelt Region, Great Lakes Region, Rocky Mountain Region, and Northwest Arctic Region.

To accomplish our objective, we:

- Reviewed federal legislative authority and PBS guidance and memorandums for exchanges;
- Conducted discussions with officials in the PBS Program Management Office, Portfolio Analysis Division, and the Office of Real Property Utilization and Disposal, as well as project executives and regional staff;
- Reviewed exchange documentation for the eight exchange projects, such as business case analyses, fact sheets, Requests for Information, and Requests for Proposals;
- Determined the amount of supplemental funding used by PBS to support each exchange; and
- Reviewed PBS's methodology to value the federally-owned property and the property or services to be received in the exchange, such as appraisals and project cost estimates.

We conducted the audit between November 2015 and July 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Our assessment of internal controls was limited to those necessary to address the objective of the audit. Identified internal control issues are discussed in the Results section of this report.

Appendix B – Exchange Project Audit Sample

Our audit sample consisted of the eight PBS exchanges that were in progress when we started the audit in November 2015. Subsequently, PBS cancelled or chose not to pursue four of the exchanges.

Auburn Federal Complex Exchange Project (Auburn exchange)

Location: Auburn, Washington
Authority cited: 40 USC 581(c)
Status: Not pursued
Description: PBS planned to convey the Auburn Federal Complex (Complex) in exchange for real property that could accommodate the Complex's tenants: GSA, the Social Security Administration, and the Federal Protective Service. Alternately, PBS considered conveying a portion of the Complex in exchange for construction services to renovate existing buildings or construct new offices on a retained portion of the Complex. PBS chose not to pursue this strategy and instead will dispose of 75 acres of the 125 acres Complex.

Charles R. Jonas Federal Building and Courthouse Exchange Project (Jonas exchange)

Location: Charlotte, North Carolina
Authority cited: 40 USC 3304
Status: Exchange agreement signed with City of Charlotte in March 2016
Description: GSA and the City of Charlotte agreed to exchange the city's Jonas Courthouse for a federally-owned 3.2-acre site with a parking lot in Charlotte, North Carolina. This is a reversal of a previous exchange in 2004 in which the City of Charlotte acquired title to the Jonas Courthouse in exchange for the parking lot. To equalize the value of the properties being exchanged, the City of Charlotte will replace the roof at the courthouse and contribute $2.86 million toward the cost of the roof replacement, with GSA being responsible for the remaining costs up to a specified amount.

Denver Federal Center Exchange Project (Lakewood exchange)

Location: Lakewood, Colorado
Authority cited: 40 USC 581(c)
Status: Not pursued
Description: PBS intended to exchange a 59-acre parcel of land at the Denver Federal Center. In exchange for the parcel, the exchange partner would provide building system repairs and upgrades in the Denver Federal Center for a building that houses the U.S. Geological Survey, the Federal Emergency Management Agency, and the Food and Drug Administration. PBS officials stated that they later believed there would not be enough repair and upgrade work to meet the value of the property. PBS then decided to pursue new construction of a laboratory facility to house the U.S. Geological

Survey and the Food and Drug Administration. PBS decided not to pursue the Lakewood exchange because of lessons learned on the Federal Triangle and State Street exchanges. PBS is now pursuing a disposal of the 59-acre parcel.

Department of Transportation John A. Volpe National Transportation Systems Center Exchange Project (Volpe exchange)

Location: Cambridge, Massachusetts
Authority cited: 40 USC 581(c)
Status: Exchange agreement signed in January 2017
Description: The Department of Transportation (DOT) occupies a 14-acre federally-owned site in Cambridge, Massachusetts. DOT is seeking the design and construction of a new facility on a portion of the property in exchange for the remainder of the site. PBS entered into a Memorandum of Agreement with DOT for PBS to employ its real estate expertise and authority to complete the new facility on behalf of DOT. The new facility will be operated and maintained by DOT.

Federal Bureau of Investigation Headquarters Consolidation Exchange Project (FBI exchange)

Location: Washington, D.C. Metropolitan Area
Authority cited: 40 USC 3304 and 581(c)
Status: PBS received revised proposals in January 2017; further action is pending appropriations
Description: The government plans to relocate and consolidate the FBI's headquarters at the J. Edgar Hoover building in Washington, D.C., and other local FBI area offices to a newly consolidated headquarters location in Greenbelt, Maryland; Landover, Maryland; or Springfield, Virginia. PBS is seeking an exchange partner to develop, design, construct, and deliver this 2.1 million rentable square foot consolidated headquarters. In exchange, the developer will receive cash and the J. Edgar Hoover building and site.

Federal Triangle South Exchange Project (Federal Triangle exchange)

Location: Washington, D.C.
Authority cited: Section 412
Status: Cancelled
Description: PBS planned to convey the GSA National Capital Region Regional Office building and its site and the Cotton Annex building and its site. In exchange for the two properties, the exchange partner would perform repair and alterations at the GSA Headquarters building as well as construction services for up to four buildings at the St. Elizabeths West Campus. The eastern portion of the GSA Headquarters building modernization was funded under the American Recovery and Reinvestment Act of 2009 and was completed in 2013. Since then, funding for the modernization of the remaining

western half has been uncertain. Developers' proposals responding to the Federal Triangle exchange Requests for Proposals did not meet the value PBS assigned to the Regional Office building and Cotton Annex building. As a result, PBS cancelled the exchange project and is now pursuing a disposal of the Cotton Annex building and its site. While the sale under the disposal process is not final, PBS accepted a bid on the Cotton Annex in February 2017.

Salt Lake City Motor Pool Exchange Project (Salt Lake City exchange)

Location: Salt Lake City, Utah
Authority cited: Section 412
Status: Exchange agreement signed in June 2016
Description: PBS originally sought to exchange the federally-owned motor pool property in Salt Lake City, Utah, for construction services at the James B. Hansen Federal Building in Ogden, Utah, including three optional projects. Based on developers' comments, PBS issued a revised solicitation. This solicitation removed the options but required the exchange partner to offer a cash equalization payment in addition to the construction services.

State Street Exchange Project (State Street exchange)

Location: Chicago, Illinois
Authority cited: Section 412
Status: Cancelled
Description: PBS planned to exchange four properties in the downtown Chicago, Illinois, retail corridor. All four properties were unsuitable for occupancy. In exchange for the four properties, the exchange partner would provide construction services to modernize 18 elevators at the Ralph H. Metcalfe Federal Building in Chicago, Illinois, as well as perform maintenance on the exterior wall of the Federal Archives and Records Center in Chicago, Illinois. The one responsive developer withdrew its proposal. As a result, PBS cancelled the State Street exchange. PBS is now pursuing a disposal of the four State Street properties.

MAR 1 7 2017

GSA

Public Buildings Service

MEMORANDUM FOR MARISA A. ROINESTAD
ASSOCIATE DEPUTY ASSISTANT INSPECTOR GENERAL
FOR AUDITING
REAL PROPERTY AND FINANCE AUDIT OFFICE

FROM: NORMAN DONG
COMMISSIONER (P)
PUBLIC BUILDINGS SERVICE

SUBJECT: Audit of PBS's Planning and Funding for Exchange Projects – Report Number A160024

The Public Buildings Service (PBS) appreciates the opportunity to review and comment on the draft audit report entitled *Audit of PBS's Planning and Funding for Exchange Projects*.

PBS agrees with the recommendations included in the draft report, namely:

1. Update exchange guidance to:
   a. Require financial and business case analyses that fully quantify risk for all potential exchanges when making the decision to exchange, dispose of, or retain a property. If an exchange is pursued, require that PBS continue to quantify risk throughout the project.
   b. Address funding for change orders, support costs, and funding shortages; as well as the use of cash equalization; and
   c. Require PBS to estimate support costs and identify funding sources when planning an exchange.
2. Revise quarterly exchange reports to congressional appropriations committees to:
   a. Include projects through completion, and
   b. Identify support costs.

PBS will develop a corrective action plan to address these recommendations and will provide the plan to the Office of Inspector General.

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In addition to the attached technical comments, PBS wants to address specifically two areas of the report that we believe require further explanation and clarification. First is the use of Building Operations budget activity funds to pay for construction management services in connection with an exchange transaction. While PBS acknowledges that the *Guidance on Proper Building Operations Funding Towards Capital Projects*, which was issued in FY 2014, does not specifically identify the BA-61 account as a source of funding for construction management services, PBS continues to assert, based on guidance from the GSA Office of General Counsel (OGC), that the Building Operations account is being used properly in the context represented within the draft report. Construction management services are an incidental and necessary part of the due diligence associated with an exchange transaction, and to not obtain such services using funds from the Building Operations account, in the absence of a line-item appropriation for the transaction, would frustrate the purpose of GSA's statutory authority to convey real property by exchange. PBS, in conjunction with OGC and the GSA Office of the Chief Financial Officer, will revise the guidance accordingly as part of the corrective action referenced above.

Second is the conclusion that the planning phase costs analyzed in connection with the eight exchange projects in the audit sample were incurred only because the properties were being proposed for exchange and would not have been incurred otherwise. For example, as noted in the draft report, PBS spent $336,000 for an environmental assessment of the Federal Triangle South properties that were being considered for exchange. As the report correctly states, PBS cancelled the proposed exchange and is now selling the Cotton Annex at auction[1] and retaining the Regional Office Building. However, the draft report does not acknowledge that disposing of the Cotton Annex also requires an environmental assessment and that the assessment commissioned in connection with the proposed exchange is now being used to support the sale of that property. PBS acknowledges, however, that the cost of the environmental assessment would have been less in the case of an outright sale of only the Cotton Annex, since a portion of the $336,000 was used to evaluate the Regional Office Building. Moreover, while GSA has determined to retain the Regional Office Building for now, the assessment provided PBS with updated useful environmental information on the property, which may reduce the cost of a follow-up assessment should GSA elect to dispose of the property in the future. Similarly, planning phase costs incurred in connection with the proposed State Street, Auburn and Lakewood exchanges are being used to support disposition of all or a portion of these properties.

Thank you again for the opportunity to review and comment on the draft report. Should you or your staff have questions, please contact Stuart Burns, Assistant Commissioner for the Office of Portfolio Management and Customer Engagement, on (202) 969-7263.

Attachment

1 Since the time that the draft audit report was issued, the Cotton Annex was sold via public auction.

Page	Comment
3	Footnote 2 - City of Charlotte has awarded the roof replacement contract, which is a firm fixed-price contract.
6	$336k for environmental assessment would have likely been incurred in a disposal scenario (could have been less since ROB is being retained).
6	Report discusses GSA spending on appraisals and environmental assessments in support of exchange and implies these were wasted costs. It is likely that many of these costs would have been incurred regardless of the method PBS utilized to remove the property from the inventory.
7	Report cites that GSA could have avoided maintenance and security costs for properties if GSA had disposed of property instead of pursuing an exchange. This assumption is difficult to make as the actual length of the disposal process for properties is typically not known when the property is reported excess.
8	Report references a Request for Qualifications (RFQ) for the Auburn exchange that included a provision for early access. The version of the RFQ shared with the audit team was in draft form, and PBS decided not to move forward with the proposed exchange prior to issuing the RFQ.
10	Report references the dollar amount PBS spent for planning in connection with exchanges. However, the report does not mention that some of this due diligence can be utilized to meet property disposal requirements.
10	PBS continues to assert, based on guidance from OGC, that the Building Operations account is being used properly in the context represented within the draft report

Appendix D – Office of Inspector General Response

Though the PBS Commissioner agreed with our audit recommendations, GSA's comments address two main areas of our report. First, GSA's comments discuss the use of Building Operations budget activity funds to pay for construction management services. Second, GSA's comments speak to exchange project planning phase costs. We maintain the original positions in our audit report, and address GSA's comments here.

First, PBS asserts that it can use the Building Operations budget activity funds to pay for construction management services on an exchange project in the absence of a line item appropriation for the transaction. However, in our view, PBS's authority to use these funds for this purpose is not certain. PBS contemplates using construction management services to oversee construction work that it is receiving as part of the exchange transaction. Normally, when the cost of a PBS construction project exceeds the prospectus level, line item funding is required for the costs of design, construction, and construction management services. Using funding from the Building Operations account for these costs is not allowable. GSA's exchange authorities do not explicitly change this requirement nor can it be assumed that the exchange authorities also provide GSA with the authority to change how the funds in the Building Operations account can be used.

Second, we are aware that some of the studies performed on exchanges that are cancelled or not pursued could possibly be used if, for example, PBS pursued a disposal. However, it is likely that not all of the studies performed for these exchanges will be useful in a subsequent disposal. By the time the studies are needed, they may be outdated and require additional funds to update. Furthermore, some costs were specific to exchanges and would not have been incurred under the disposal process. Also, when an exchange is cancelled or no longer pursued, the time and funds spent to maintain the properties in PBS's inventory have been incurred and cannot be recouped. PBS will then incur additional maintenance and security costs while it works to dispose of these properties.

Finally, GSA's technical comments included two minor revisions to pages 3 and 8. We incorporated both revisions into this final audit report.

Appendix E – Report Distribution

Acting GSA Administrator (A)

Acting PBS Commissioner (P)

Deputy PBS Commissioner (P)

Chief of Staff (P)

Regional Administrators (1A, 4A, 5A, 8A, 10A, and WA)

Regional Commissioners (1P, 4P, 5P, 8P, 10P, and WP)

Regional Counsel (1L, 4L, 5L, 8L, 10L, and WL)

Assistant Commissioner, Office of Real Property Asset Management (PT)

Assistant Commissioner, Office of Real Property Utilization & Disposal (PI)

Chief Administrative Services Officer (H)

GAO/IG Audit Management Division (H1G)

PBS Audit Liaison (H1G)

Assistant Inspector General for Auditing (JA)

Director, Audit Planning, Policy, and Operations Staff (JAO)