LIMITED REVIEW OF THE ADMINISTRATION OF
LEASE NUMBER GS-06P-60009
120th AND L STREETS, OMAHA, NEBRASKA
REPORT NUMBER A090129/P/6/R09004
SEPTEMBER 29, 2009

U.S. GENERAL SERVICES ADMINISTRATION
Office of Inspector General

Date : September 29, 2009

Reply to
Attn of : Heartland Field Audit Office (JA-6)

Subject : Limited Review of the Administration of Lease Number GS-06P-60009, 120th and L Streets, Omaha, Nebraska, Report Number A090129/P/6/R09004

To : Michael T. Brincks
Acting Regional Administrator (6A)

We have completed a limited review of the administration of Lease Number GS-06P-60009 for the Federal Bureau of Investigation (FBI) in Omaha, Nebraska. This review was conducted as a result of lease funding issues and questions raised by the FBI to the General Services Administration (GSA) Office of Inspector General regarding this leasing action. We have discussed our review observations with the Public Buildings Service (PBS) management and we are performing an additional limited review of the costs associated with the FBI tenant improvement work for the subject lease. The results of that review will be issued under separate cover.

Background

The Public Buildings Act of 1959, as amended, requires that a prospectus be submitted to both houses of Congress for approval for proposed leases above a dollar threshold. The purpose of the prospectus is to provide Congress with the ability to review the overall propriety of major leases. The GSA component responsible for awarding and administering leases is the PBS.

On October 26, 2005, the Committee on Transportation and Infrastructure in the House of Representatives authorized GSA to lease up to 112,337 rentable square feet (rsf) and 85 parking spaces for the FBI in Omaha, Nebraska. The approved rental amount was $4,044,132 per year ($36/rsf) for a lease term of 15 years.

The solicitation for offers (SFO), issued September 25, 2006, required offerors to submit bids for a build-to-suit building to be located at the northwest corner of 120th and L Streets in Omaha, Nebraska. The lessor was required to execute a site purchase option for up to nine acres of land at a cost of $12 per square foot. PBS awarded the lease to Noddle Companies on March 14, 2007. As of July 16, 2009, PBS has accepted the space and the FBI is currently in the process of moving into the new facility.

We note that at the start of our review, PBS had executed three supplemental lease agreements (SLAs) that modified the lease contract. During our review and after several discussions with PBS officials, PBS executed a fifth SLA that rescinded the third SLA to the lease contract.

Objective, Scope, and Methodology

The objective of this limited review was to evaluate the administration of Lease Number GS-06P-60009 with a focus on lease actions that impacted the rental rate of the lease.

To accomplish our objective, we reviewed (1) lease files and related documentation, and (2) applicable appropriation laws, regulations, and guidance. We also held discussions with Region 6 PBS, Central Office PBS, and FBI officials, and obtained guidance from the Counsel to the Inspector General.

Although this review was limited to administrative lease actions, we are also reviewing the FBI tenant improvement costs for this lease, and the results of that review will be issued in a separate report.

The review was conducted 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results of Review

We identified a lease modification, which PBS has since corrected, that increased the total lease payments above the approved prospectus limit. PBS increased the lease payments to pay for tenant improvement work under the lease. The FBI designed and requested the tenant improvements for the space but the responsibility for the funding of this work was a matter of dispute between PBS and the FBI. This dispute led PBS to increase the lease rental rate to fund the FBI’s tenant improvements. In addition, we determined that the additional rent for this lease modification was approximately $1 million more than the value of the tenant improvement work included in the modification.

PBS officials stated that they executed the lease modification because they believed it was better to increase the lease rental payments in order to fund the FBI tenant improvement work rather than interrupt the project and cause costly project delays. This goal is admirable, however, some of the lease issues could have been resolved more efficiently if PBS officials had sought additional legal or operational guidance to evaluate alternate approaches to resolve these issues.

We also noted that the lease file does not adequately document why some site costs were added to the lease and why some of these additional site costs were funded by GSA.

Funding Tenant Alterations – SLA 3

Effective December 19, 2008, GSA and the lessor executed SLA 3. In this SLA, the lessor agreed to pay $2.2 million for FBI tenant improvements in exchange for (1) the removal from the lease of a requirement that the lessor pay $326,490 of annual real estate taxes without reducing the annual rental rate and, thus, increasing the annual rental payment to the lessor by $326,490 for 15 years, and (2) an increase in the lease rental rate of $9,830 per year. This SLA resulted in a new effective annual rent of $4,068,597, which was $24,465 above the rental rate approved in the prospectus.

We also determined that PBS incorrectly calculated the present value of the additional rental payments included in SLA 3. This error could have resulted in an overpayment of approximately $1 million had SLA 3 not been reversed.

The lease prospectus, the SFO, and PBS leasing guidance[1] require the lease rental rate to include all services and real estate taxes. As a result, in executing SLA 3, PBS not only increased the rental rate in excess of the prospectus limit , but also took action contrary to lease requirements and guidance. However, this issue was resolved when PBS executed SLA 5 on May 27, 2009. SLA 5 rescinded SLA 3 in its entirety and provided for a lump sum payment to the lessor for the FBI's tenant improvement work. This lump sum amount was funded by the FBI.

PBS officials stated that SLA 3 was executed to ensure continued construction of the FBI's new space. After the project began, a difference of opinion arose between PBS and the FBI as to who was responsible for funding the FBI's tenant improvement work. The FBI refused to fund tenant improvement work that, per PBS, was not included in the lease. Without funding from the FBI, PBS officials sought alternative solutions to maintain the scheduled project completion date and to prevent a work stoppage and the related delay damages. In addition to a project suspension and related delay claim, PBS advised that any slippage in the completion of the new space would result in multiple leases for the FBI space expiring prior to occupancy of the new space. Accordingly, lease extensions and/or temporary space would be needed, resulting in additional costs to the Government. One PBS official advised us that the owner of the largest location currently leased by the FBI would not extend the occupancy period at all.

We also noted that PBS incorrectly negotiated the present value of the additional annual rental rate ($326,490/year and $9,830/year) accruing to the lessor under SLA 3. The lease file documentation did not include a price negotiation memorandum or an

[1] According to the October 31, 2007, Updated Lease Prospectus Guidance Memorandum, real estate taxes are a component of net rent and must be included in the proposed rent compared to the prospectus threshold.

explanation of the analysis performed. The file included very little documentation but indicated that a discount rate of 8 percent was used in the present value analysis and this resulted in a present value of:

Item	Annual Rent	Present Value*
Tax Reduction	$326,490	$2,794,584
Rent Increase	$9,830	$84,141
Totals	$336,320	$2,878,725
Tenant Improvements		$2,200,000

*The present value represents the total value of each annual payment for the 15 year lease term at an annual discount rate of 8 percent. The value of the tenant improvement work is already a present value because this is a lump sum payment during construction.

There was no support in the lease file to explain the $678,725 difference between the value of the tenant improvement work as compared to the present value of the additional lease payments to the lessor. The file documentation made a reference to a "2nd loan origination fee" of $594,584 but did not explain what this was. We discussed this with PBS officials who also could not explain this difference or the reference to a loan origination fee. In addition, the lease file does not explain why an 8 percent discount rate was used in the present value analysis. We noted that the lease required the use of a 6.3 percent discount rate in the evaluation of offers. Depending on the discount rate used, the difference between the tenant improvement allowance provided by the lessor and the present value of the additional rental payments accruing to the lessor would have totaled approximately $1 million. Had SLA 3 not been rescinded, the Government would have been committed to spending up to an additional $1 million without clear support for the expenditure.

While we understand PBS's intention to keep the project moving and avoid delays, we believe these issues could have been resolved more efficiently if PBS had sought input from legal counsel or other management sources. We have discussed our concerns with PBS management and they have informed us that they have taken corrective action. As a result, we are not making a recommendation.

Additional Site Costs – Lease Contract and SLA 1

The lease file included two contract changes that increased the cost of the lease to the Government because of increases in costs related to the site. The lease file, however, did not adequately explain why these changes were needed and did not justify the funding for these increases in the site costs.

As noted in the Background section of this report, the lessor was required to construct a building at 120th and L Streets in Omaha, Nebraska. GSA had an assignable purchase option for this site that allowed for the unencumbered purchase of 6 to 9 acres at a price of $12 per square foot. Prior to the execution of the purchase option, the lease was modified due to increased costs for road maintenance and site modifications.

Road Maintenance. We noted that the lease contract included an annual rental rate of $36.18/rsf even though the lessor had offered $35.95/rsf. This difference of $0.23/rsf was addressed in Paragraph 14 of the lease contract which states that the additional $0.23/rsf is for the maintenance of private roads and grounds at an annual cost of $25,321. The lease file did not contain a price negotiation memorandum for this item or any other analysis to support the cost. The contracting officer explained that this cost increase was allowed because the lessor did not know about this road maintenance cost at the time of bidding and the owner of the site required a commitment to pay this cost before execution of the site purchase option.

Similar to SLA 3, the lease file contained no legal determination to support that this item was required to exercise the option to purchase the site. Further, we noted that (1) the SFO required all bidders to include all site costs in their bids, and (2) the purchase option for the site does not require this expense. As a result, it is unclear why this cost was added to the lease rental rate. The contracting officer stated that he determined the most cost effective alternative to settle this matter was to add the road maintenance cost to the rental rate because (1) the site owner demanded payment of road maintenance costs in order to sell the site even though this was not required in the purchase option, and (2) a legal battle over this issue would have been more costly, in terms of delay and project costs, than the cost to include this expense in the rental rate.

Retaining Wall and Additional Land. SLA 1 was effective on April 29, 2008, and provided for lump sum payments by GSA of $72,132 for the purchase of additional land and $575,625 for construction of a shoring wall. The lease file did not contain a price negotiation memorandum addressing these items. The only documentation related to these issues was a memo to the file that stated the retaining wall was required due to changes by the land owner prior to the purchase of the site by the lessor. The lease file did not contain a legal opinion and did not explain why the lessor could not simply exercise the option to purchase the site. The lease file also did not explain why the extra land was needed or the rationale for why these items were expenses that the Government should fund. Lastly, the lease file did not document why GSA, instead of the FBI, paid for these expenses.

The contracting officer informed us that the land owner was being very difficult and caused this situation. The contracting officer stated that he felt that the lessor should not have to incur this additional cost because the lessor could not have known about it during the bidding process. The contracting officer decided that the resolution of this issue was less expensive and better for the project than litigation. The contracting officer noted that he did have some discussions with legal counsel who was not in favor of condemnation or other legal action.

PBS officials agree that the lease file should be documented to fully support these decisions and that formal consultation with management, counsel's office, or others may have helped to more efficiently resolve these issues. We also discussed our concerns regarding GSA's funding of lease requirements with PBS management and we do not believe that this is a systemic problem.

Conclusion

While PBS personnel maintain that they were attempting to avoid delays on this lease project, we believe that if PBS had requested assistance on the issues related to this leasing action, these matters could have been resolved more efficiently and effectively. SLA 3, in particular, put significant taxpayer funds at risk without sufficient justification and with little or no input from outside sources. PBS eliminated this risk after the start of our review by executing SLA 5 and rescinding SLA 3. Also, PBS has informed us that it has learned from its experience on the FBI lease and will do things differently in the future. As a result, this report does not contain a recommendation and no additional action is necessary.

Internal Controls

This review was limited to an analysis of the administrative actions for the subject lease and as a result, our evaluation of internal controls was limited to the items mentioned in the Results of Review and Conclusion sections of this report.

If you have any questions or would like additional information regarding the report, please contact Erin Kraft or me at 816-926-7052.

Michael J. Capper
Audit Manager
Heartland Field Audit Office

APPENDIX

LIMITED REVIEW OF THE ADMINISTRATION OF
LEASE NUMBER GS-06P-60009
120th AND L STREETS, OMAHA, NEBRASKA
REPORT NUMBER A090129/P/6/R09004

REPORT DISTRIBUTION

	Copies
Acting Regional Administrator, Heartland Region (6A)	3
PBS Deputy Commissioner, Heartland Region (6P)	1
Director, Realty Services Division (6PR)	1
Director, Internal Control & Audit Division (BEI)	1
Assistant Inspector General for Auditing (JA & JAO)	2
Regional Inspector General for Investigations (JI-6)	1
Deputy Assistant Inspector General for Real Property Audits (JA-R)	1