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United States General Accounting Office
Washington, DC 20548

June 5, 2001

Senator James M. Inhofe
Senator John McCain
United State Senate

Subject: *Acquisition of Leased Space for the U.S. Patent and Trademark Office*

This letter responds to your requests for a review of the data, assumptions, and conclusions reached by the General Services Administration (GSA) and the Patent and Trademark Office (PTO) relating to the acquisition of about 2 million square feet of leased space for the consolidation of PTO activities. This build-to-suit lease, valued at approximately \$1.2 billion over its 20-year term, was signed in June 2000. According to GSA officials, the lease can be terminated without penalty to the government only if the lessor fails to perform.

As agreed with you, the objective of our work was to respond to allegations and questions from two public interest groups about the PTO lease acquisition. One public interest group made the following allegations concerning the procurement process for the lease: (1) GSA improperly awarded the lease to an offeror who had not complied with the solicitation's stated requirements, (2) GSA failed to complete the construction of the interior finishes phase of the project as required by the Competition in Contracting Act of 1984 (CICA), and (3) GSA used an illegal cost-plus-a-percentage-of-cost contract.¹ The second public interest group asked (1) whether the requirements in GSA's Solicitation for Offers (SFO) for the PTO lease transformed the lease from an operating lease to a capital lease under Office of Management and Budget (OMB) Circular A-11; (2) whether the new facility will be able to house all PTO employees and contractors throughout the lease term because the staff may grow,² including whether this growth invalidates the potential cost savings from consolidation; (3) whether some of the standard requirements of the lease, such as a day care center and a fitness center, are essential to providing adequate office space for PTO; (4) whether the cost estimates for the tenant improvement allowance and furniture costs are excessive; and (5) whether constructing the PTO facility would have been less costly than leasing it. The methodology we used to respond to these allegations and questions is discussed in enclosure II.

¹We consolidated all their allegations into three allegations.

²PTO's workload is projected to grow 116 percent between 2000 and 2005.

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Abstract

This letter responds to your requests for a review of the data, assumptions, and conclusions reached by the General Services Administration (GSA) and the Patent and Trademark Office (PTO) relating to the acquisition of about 2 million square feet of leased space for the consolidation of PTO activities. This build-to-suit lease, valued at approximately \$1.2 billion over its 20-year term, was signed in June 2000. According to GSA officials, the lease can be terminated without penalty to the government only if the lessor fails to perform. As agreed with you, the objective of our work was to respond to allegations and questions from two public interest groups about the PTO lease acquisition. One public interest group made the following allegations concerning the procurement process for the lease: (1) GSA improperly awarded the lease to an offeror who had not complied with the solicitations stated requirements, (2) GSA failed to complete the construction of the interior finishes phase of the project as required by the Competition in Contracting Act of 1984 (CICA), and (3) GSA used an illegal cost-plus-a-percentage-of-cost contract. 1 The second public interest group asked (1) whether the requirements in GSAs Solicitation for Offers (SFO) for the PTO lease transformed the lease from an operating lease to a capital lease under Office of Management and Budget (OMB) Circular A-11; (2) whether the new facility will be able to house all PTO employees and contractors throughout the lease term because the staff may grow, 2 including whether this growth invalidates the potential cost savings from consolidation; (3) whether some of the standard requirements of the lease, such as a day care center and a fitness center, are essential to providing adequate office space for PTO; (4) whether the cost estimates for the tenant improvement allowance and furniture costs are excessive; and (5) whether constructing the PTO facility would have been less costly than leasing it. The methodology we used to respond to these allegations and questions is discussed in enclosure II.

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Results in Brief

In response to the first public interest group's allegations, we found nothing improper in GSA's award of the lease for the PTO facility. This procurement has also been reviewed by the Department of Commerce's (DOC) Inspector General and later in litigation in federal court. None of these reviews resulted in a conclusion that the procurement activities had been conducted improperly.

In response to the questions from the second public interest group, we found that GSA acted in accordance with OMB's and its own guidance in determining that the PTO lease was an operating lease.³ It is currently unknown whether PTO's new space will meet all of its future housing needs. A number of different dynamics could mitigate the need for additional space in spite of the anticipated growth in workload, such as PTO's efforts to automate its increasing workload and allow greater use of telecommuting by its staff, and its success or failure in hiring and retaining staff. Although the cost of housing future staff growth is unknown, it is a moot point because any future housing needs would be incurred under the PTO consolidated and unconsolidated scenarios. Further, PTO's estimates of substantial savings from consolidation seem reasonable. Features such as day care and fitness centers are either authorized by law or governmentwide policy and PTO had a justification that appeared reasonable. None of the information available at this time indicated that the funding planned for tenant improvements was excessive, and the competitive procurement for furniture is aimed at achieving the best value for the money. GSA's tenant improvement allowance for the PTO facility exceeds its normal standard tenant improvement allowance because it includes additional necessary cost elements.⁴ Lastly, as we have previously reported, construction of the PTO facility would be less costly than leasing; however, that was not a viable alternative at the time GSA made the decision for the PTO facility because funds were not available to provide for government ownership. The issues are discussed in more detail in enclosure I.

Background

Since the 1960s, PTO has been in leased space in the Crystal City area of Arlington, VA. Currently, PTO has 33 leases occupying all or portions of 18 buildings in Crystal City.⁵ Its annual rent for these spaces is about \$58 million to house the current 6,400 PTO employees.⁶ PTO fully occupies 5 buildings and shares the other 13 with other government and private sector tenants.

³If a GSA lease, being self-insured, is determined to be an operating lease, then the yearly rent is scored against GSA's budget authority 1 year at a time. If a GSA lease is determined to be a capital lease, then the net present value of the entire cost of the full term of the lease is scored against GSA's budget authority in the year the lease becomes effective. For example, because GSA is considered to be self-insuring, PTO's yearly rent of \$62 million would be scored against GSA's budget authority for each of the next 20 years as an operating lease. If it was a capital lease, the net present value of the \$1.2 billion in total lease costs would be scored against GSA's fiscal year 2003 budget authority. Also see footnote 12.

⁴The standard tenant improvement allowance is the financial allotment that GSA gives an agency for finishing and customizing the space to the agency's specifications. The PTO tenant improvement allowance includes this finishing and customizing plus installation of all branch and secondary distribution systems for mechanical and electrical services.

⁵PTO also has three warehouse locations that are not being consolidated into the new facility.

⁶This rate cannot be projected out 20 years because the rents are not fixed as in the new lease and may rise or fall over this period.

In 1989, PTO began working with GSA on approaches to meet its long-range space requirements. In August 1995, OMB authorized GSA to seek congressional approval to consolidate PTO operations at a single location in new leased space.

By resolutions, the appropriate Senate and House committees approved the prospectus for the lease procurement in October and November 1995, respectively.⁷ The resolutions authorized the competitive procurement of a 20-year operating lease for about 2 million square feet for the purpose of consolidating PTO in an area between the Potomac River and Dulles International Airport in Northern Virginia.

On June 26, 1996, GSA issued the SFO for the lease. The procurement was to be conducted in two phases. In Phase I, the offerors were to provide basic information about their sites, development plans, qualifications of design teams and developers, preliminary financial information, and a phase 1 environmental assessment and questionnaire. In Phase II, selected offerors were to provide more detailed information regarding the site, proposed design of the facility, the interior architect, the development schedule, and the operations and maintenance firm. On December 23, 1996, GSA received six offers. On March 11, 1997, four of the offerors were invited to proceed to Phase II of the procurement. After a bid protest to GAO and litigation concerning this procurement, on June 1, 2000, GSA signed a 20-year lease with LCOR Alexandria L.L.C. for approximately 2.2 million rentable square feet,⁸ which are to be built to suit GSA/PTO needs and to house 7,100 staff at the Carlyle site in Alexandria, VA. The lease is valued at \$1.24 billion over 20 years, plus operating expenses and taxes.

The City of Alexandria, which is presently reviewing the design of the project, must approve the design before the lessor can proceed. According to PTO's Administrator for Space Acquisition, it anticipates that LCOR will be able to begin construction of the five-building complex in October or November 2001. PTO plans to begin moving into the complex in late 2003.

Agency Comments

In May 2001, we received written comments from the Acting Under Secretary of Commerce for Intellectual Property and Acting Director, PTO. We received oral comments from OMB's Branch Chief for GSA and Justice and GSA's National Capital Region Assistant Regional Administrator, Public Buildings Service. The PTO official concurred with our report and provided additional, clarifying, or updated information, which has been included in the report. GSA concurred with our report without comments, and OMB had no comments.

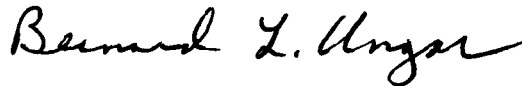
We conducted our review at GSA and PTO between September 2000 and April 2001 in accordance with generally accepted government auditing standards.

⁷A prospectus, which is a justification for a proposed project, includes information on the size, cost, location, and other features and is submitted to the appropriate House and Senate authorizing committees.

⁸Rentable square feet is a term used in the commercial real estate market that includes occupiable square feet plus the tenants' proportional share of common building areas, such as rest rooms, exit stairways/fire corridors, and lobbies. Occupiable square feet is a term used by the government to identify the square footage of space that can actually be used to house agency operations.

We are sending copies of this letter to Senators Ted Stevens, Robert Byrd, Orrin Hatch, Patrick Leahy, Bob Smith, Harry Reid, Judd Gregg, Ernest Hollings, Ben Nighthorse Campbell, Byron Dorgan, Peter Fitzgerald, and Max Baucus; and Representatives C. W. Bill Young, David Obey, Jim Sensenbrenner, John Conyers, W. J. Tauzin, Don Young, James Oberstar, Cliff Sterns, Edolphus Towns, Steven LaTourette, Jerry Costello, Frank Wolf, Jose Serrano, Ernest Istook, and Steny Hoyer in their capacities as Chairmen or Ranking Members of committees and subcommittees with jurisdiction over GSA, Commerce, and PTO activities; the Honorable Dick Arney, House Majority Leader; Mr. Nicholas Godici, Acting Director, Office of Patents and Trademarks; the Honorable Thurmond Davis, Acting Administrator of GSA; the Honorable Donald Evans, Secretary of Commerce; and other interested parties. The letter will also be available on GAO's home page at www.gao.gov.

Key contributors to this letter were Ronald L. King and Thomas G. Keightley. If you have any questions, please contact me or Ron King on (202) 512-8387.

A handwritten signature in cursive script that reads "Bernard L. Ungar".

Bernard L. Ungar
Director, Physical Infrastructure Issues

Detailed Information on the Questions

GSA's Award of the Lease Appears Proper

One public interest group had questioned whether the General Services Administration (GSA) improperly awarded the lease to LCOR because the offeror had not complied with the solicitation's stated requirements. We found nothing improper in GSA's evaluation and selection of LCOR's offer. According to the public interest group, LCOR did not meet the Solicitation for Offers' (SFO) minimum requirement that the offeror have the necessary zoning and master land-use plan approval for the required amount of office space and for the above-grade parking garages LCOR proposed to build at the site. The public interest group believed that LCOR was improperly allowed to correct these deficiencies after it was awarded the lease when, as a result of the City of Alexandria changing its land-use plans, LCOR's design received the necessary approvals. The public interest group essentially maintains that GSA should have instead eliminated LCOR from the competition and that GSA otherwise provided LCOR with a significant competitive advantage by allowing it to obtain the approvals after the award.

We found that under the SFO, LCOR was not required to have all the necessary planning and zoning approvals in place prior to award of the lease. Further, according to GSA, LCOR provided it with sufficient assurances that it could obtain the necessary approvals and meet the planning and zoning requirements to enable GSA to determine that LCOR had the capability to provide the required office space and the proposed parking facilities at the Carlyle site.

In this regard, the SFO required LCOR to submit a legal opinion describing in detail the site's compliance with land-use and zoning restrictions and confirming that the planning and zoning for the site had been completed in a manner sufficient to meet the SFO's requirements. Further, GSA amended the SFO during the competition to allow an offeror to be considered compliant with land-use restrictions even if it had not completed and received all the necessary site plan approvals. An offeror without all the necessary approvals prior to award could thus compete as long as the jurisdiction's normal approval process would permit construction of the required amount of office space and completion of a facility meeting all requirements of the SFO. Here, LCOR obtained the necessary approvals in conformance with the government's schedule.

We also found that GSA was not required to hold a separate competition for the construction of the interior finishes phase of the project. Under the SFO, the construction of the interior of the buildings is not a separately competed phase of the project; it is to be performed by the selected developer following the construction of the exterior shell of the buildings.

We believe that GSA's approach for the interior construction phase seems reasonable. The public interest group appeared to be concerned that the lack of a detailed design and cost ceiling for the interior phase of the project may increase costs because the developer would be in a "sole-source" position. However, it appears that GSA has addressed these concerns, and we have no basis on which to disagree with GSA's response. Specifically, according to GSA, the interior construction phase is designed to minimize the risks to the government and the developer. These risks result from the fact that several years may elapse between the award of the lease and the completion of all constructed space, during which the space requirements of the government may change. This approach gives GSA and the Patent and Trademark Office (PTO) design flexibility and the ability to defer final design decisions until

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closer to the occupancy date, reducing the probability of change orders and the need to accommodate reengineered space layouts that may be required during this interval. The SFO establishes a tenant improvement allowance for interior finishes that, with any additional funds provided by PTO, GSA considers a cost ceiling for this phase of the project. GSA stated that it will closely manage this phase of the project and that the SFO establishes several measures (such as budgets and subcontract competition) that should control costs incurred by the developer in completing the interior of the buildings. GSA believes that alternative measures, such as detailed specifications and pricing prior to lease award, would subject the government to a higher degree of risk than the measures provided in the SFO. We agree that GSA's approach seems reasonable in that change orders can be very costly.

We also do not believe that the interior construction phase of the procurement results in a prohibited cost-plus-a-percentage-of-cost contract.⁹ The lease agreement itself is simply not a cost-plus-percentage-of-cost contract. Rather, the lease provides for, in addition to the tenant improvement allowance discussed previously, a fixed lease payment by the government (subject to certain adjustments) to the contractor that is to include the contractor's fee (profit). Thus, the lease does not allow the contractor to base its fee on the percentage of costs it incurs.

We note that the Department of Commerce (DOC) Inspector General's earlier review of this procurement had found the initial interagency memorandum of agreement between GSA and PTO to manage the project (not the lease agreement itself) was similar to a prohibited cost-plus-percentage-of-cost contract.¹⁰ The Inspector General found that under the initial arrangement, GSA had little incentive to monitor costs or rein in overdesigning or overbuilding by PTO. According to the Inspector General, GSA would receive a percentage fee for its services based on the costs incurred by PTO to accomplish the design and construction of the interior of the buildings, and these costs had not been capped under the lease agreement. GSA and PTO have since addressed the Inspector General's concerns in a Memorandum of Understanding between the agencies that limited the fee that GSA could receive. Further, the lease agreement established several cost control measures, such as requiring the lessor to identify cost control methods and explain how selecting alternative options, cost estimating, and monitoring will be done, to ensure that the interior finishes are delivered within the allowance established for this work plus any additional funds provided by PTO for interior finishes.

As previously mentioned, this procurement has also been reviewed by the DOC Inspector General and later in litigation in federal court.¹¹ None of these reviews resulted in a conclusion that the procurement activities had been conducted improperly.

⁹41 U.S.C. 254(b) prohibits such contracts because they provide a contractor an incentive to increase costs to the government by basing its fee on the percentage of costs incurred.

¹⁰The Inspector General did not actually conclude that the agreement between GSA and PTO was a prohibited cost-plus-percentage-of-cost contract but that the agreement presented a similar risk of increased costs.

¹¹In December 1998, a competitor for the lease, the Charles E. Smith companies, filed a lawsuit in U.S. District Court, Eastern District of Virginia, alleging that the SFO's requirements overstated the government's minimum needs. Specifically, Smith alleged that it was disadvantaged in the competition because its proposal to renovate existing buildings was uniquely affected by the excess requirements. On July 29, 1999, the court ruled in favor of the government, and this ruling was affirmed on appeal. CESC Plaza Ltd. Partnership v. U.S. Dept. of Commerce, No. 99-2432, 2000 U.S. App. LEXIS 12823 (4th Cir. June 8, 2000) (per curiam). An earlier bid protest filed at GAO by Smith against certain

GSA Followed OMB's and Its Own Guidance in Scoring the Lease as an Operating Lease

The public interest group questioned whether the requirements in GSA's SFO for the PTO lease transformed the lease from an operating lease to a capital lease under Office of Management and Budget (OMB) Circular A-11.¹² The public interest group contends that contrary to OMB's criteria for an operating lease,

- the lease term would exceed 75 percent of the asset's estimated economic life,
- the facility would be special purpose,
- there would be no private sector market for the PTO facility, and
- the present value of the minimum lease payments would exceed 90 percent of the fair market value (FMV) of the asset at the beginning of the lease term.

To qualify as an operating lease, a lease must meet six OMB criteria set forth in Appendix B of OMB Circular A-11.¹³ Before analyzing these factors, we discussed them with OMB to better understand its interpretation of these criteria. Table 1 shows OMB's six criteria and our analysis of whether the PTO lease met the criteria.

requirements of the SFO was dismissed by GAO as untimely. The Charles E. Smith Companies, B-277391, Sept. 25, 1997, 97-2 CPD ¶ 88. Smith and other plaintiffs had also sought to prevent the consolidation of the PTO facilities in Alexandria on the basis that the government failed to comply with environmental law requirements. The U.S. District Court, District of Columbia, decided this case in favor of the government in Young v. General Services Administration, 99 F. Supp. 2d 59 (June 1, 2000). On December 14, 2000, the DC Circuit Court affirmed the ruling.

¹²If an agency's lease is determined to be an operating lease, budget authority is required for the estimated total payments expected to arise under the full term of the contract or, if the contract includes a cancellation clause, an amount sufficient to cover the lease payments for the first year plus an amount sufficient to cover the costs associated with cancellation of the contract. In a limited number of cases, where funds are self-insuring under existing authority, only the amount of budget authority needed to cover the annual lease payment is required to be scored. If an agency's lease is determined to be a capital lease, budget authority will be scored in the year in which the authority is first made available in the amount of the net present value of the government's total estimated legal obligations over the life of the contract. For both operating and capital leases, outlays will be scored over the lease term equal to the annual lease payments. For example, since GSA is considered to be self-insuring, PTO's yearly rent of \$62 million would be scored against GSA's budget authority for each of the next 20 years as an operating lease. If it was a capital lease, the net present value of the \$1.2 billion in total lease costs would be scored against GSA's fiscal year 2003 budget authority.

¹³According to OMB officials, OMB reviews the scoring of a lease only when the prospectus is prepared. OMB considers it the agency's responsibility to score the lease when it is ready for signature.

Table 1: Comparison of OMB's Six Criteria to the PTO Lease

| OMB's six criteria for determining an operating lease | GAO Analysis of GSA lease for PTO facility |
|---|---|
| Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the government at or shortly after the end of the lease term. | Ownership of the asset remains with the lessor. |
| The lease does not contain a bargain-price purchase option. | Although the lease does contain a provision providing the right to purchase the facility, we saw no evidence that the option to purchase at about \$821 million at 20 years or the FMV at 20 years is a bargain-price purchase option. According to an OMB official, the purchase price has to be equal to or near the FMV of the property to meet this criterion. |
| The lease term does not exceed 75 percent of the estimated economic life of the asset. | The 20-year term of the lease is not greater than 75 percent of the expected 30-year or more economic life of the building. Both OMB and GSA officials said the expected life of the building applies to the exterior structure itself, not its systems. The SFO required that the exterior structure be built to last at least 50 years. |
| The asset is a general-purpose asset rather than being for a special purpose of the government and is not built to unique specifications of the government lessee. | On the basis of interviews with GSA and OMB officials, our review of the SFO, the program of requirements, the independent appraisal, and the location of the property and its proximity to public transportation and major connector roads, we concluded that this is a general-purpose asset. Both OMB and GSA officials said that special-purpose assets refer to such items as border stations and courthouses but generally not to office building requirements such as PTO's. Although some of the features of the buildings are being built to meet PTO's needs, they do not appear to be of the type that would preclude other tenants from occupying the space. Also, GSA's Inspector General concluded in its review that this was not a special purpose asset. |
| There is a private sector market for the asset. | There is no evidence that there would not be a private sector market for the facility given its basic design and the location of the buildings. The lease allows the government to purchase all or a designated portion of the facility. If the government does not buy the property, the lessor could sell the five buildings separately, thus making the buildings easier to market. Also, GSA's Inspector General concluded in its review that there is nothing in the design that would diminish future marketability. |
| The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the FMV of the asset at the beginning of the lease | The present value of the minimum PTO lease payments over the life of the lease does not exceed 90 percent of the FMV of the asset at the beginning of the |

term.

lease term. GSA used data from the lease and calculated the FMV on the basis of government construction costs. Further, to ensure that the lease was an operating lease, GSA determined the FMV using another method and had the FMV determined by an appraisal. These figures were inserted in the appropriate formula, and in both cases the calculations resulted in an operating lease.

Source: OMB Circular A-11, GSA and GAO

To determine whether the present value of the minimum lease payments over the life of the lease would not exceed 90 percent of the FMV of the asset at the beginning of the lease term, GSA has a scoring formula that has been reviewed by OMB. According to OMB officials, they used the same formula when they initially scored the lease on the basis of the prospectus in 1995. For scoring the PTO lease prior to signing it in June 2000, GSA used Appendix C, valid through the end of January 2001, of OMB Circular A-94 to determine the discount rate of 6.2 percent.¹⁴ We confirmed that GSA calculated the other appropriate figures for the formula from the lease—occupiable square feet (OSF), lease award date, effective date of the lease, rent per OSF, operating cost per OSF, taxes and insurance per OSF, and lessor management costs per OSF. The last figure needed to complete the formula is the FMV of the leased property.

We confirmed that GSA followed its *General Construction Cost Review Guide for Federal Facilities* in making its determination of the FMV by reviewing its estimate.¹⁵ According to a GSA official, the FMV for the PTO facility was estimated on the basis of the review guide's cost to construct the facility. This guideline provides data and calculation procedures to establish planning phase cost estimates for new construction projects. According to GSA officials, this is the standard guidance used for estimating the construction of federal facilities. An OMB official verified that this guidance was the appropriate guidance for estimating federal construction costs. This figure was used in the scoring formula, which showed it was an operating lease.¹⁶ The OMB guidance in effect at the time that GSA scored the lease prior to signing it did not specifically indicate how the FMV should be calculated. Further, according to a GSA official, to ensure that the lease was an operating lease, GSA determined the FMV using another method and had the FMV determined by an appraisal. For the other method, he obtained the FMV by inflating the 1995 FMV to reflect increased construction costs that have occurred since the original estimate. Using either this figure or the appraisal figure for the FMV in the scoring formula resulted in an operating lease.

In July 2000, after the lease was signed, OMB issued new scoring guidance that more specifically addressed how the FMV should be calculated. Because no asset existed, as of the date the lease was signed, OMB's new guidance says:

¹⁴The guidance provides 10-year and 30-year discount rates, 6.1percent and 6.3 percent, respectively. OMB officials said that for 20 years one should interpolate the difference between the 10-year and 30-year rates, which would be 6.2%.

¹⁵*General Construction Cost Review Guide for Federal Facilities*, Oct. 1999, Office of the Chief Architect.

¹⁶We have not discussed the specific figures used in the calculation because certain information, such as operating expenses and management expenses per OSF, are proprietary information of the lessor.

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“...the fair market value of the proposed asset should be calculated based on the Government’s estimate of the cost to construct a facility equal in size and other characteristics to the amount of space to be leased. The estimate should include consideration of the Government’s total direct and indirect costs of the facility, including land, design, site improvements and management costs.”

This is the same method GSA used to score the lease in June 2000.

For the purpose of this review, we assessed GSA’s conformance with existing OMB and GSA guidance relating to scoring the PTO lease. However, we did not independently assess the government’s criteria and guidance related to scoring proposed facility acquisitions. We plan to include such an assessment in a broad review we have initiated on the government’s overall approach to acquisition, management, and disposal of real property.

It Is Unknown Whether PTO’s New Space Will House All Future Space Needs

The public interest group believed the new facility will not be able to house all PTO employees and contractors throughout the lease term because it believes PTO staff could grow to 9,000, which is 1,900 higher than the planned occupancy, by the occupancy date of about 2003. Further, the group believed that this growth would diminish or eliminate the potential cost savings from consolidation.

It is unknown whether PTO’s new space will meet all of its future housing needs. A number of different dynamics could mitigate the need for additional space in spite of the anticipated growth in workload, such as PTO’s efforts to automate its increasing workload and allow greater use of telecommuting by its staff, and PTO’s success or failure in hiring and retaining staff.

Whether the projected \$72 million in savings from consolidating is realized or not, PTO would still have to pay for housing increased staff under either a consolidated or unconsolidated scenario. Also, there are other benefits from consolidation, such as improved security and compliance with current fire, life safety, and accessibility codes and requirements, that are not available in all of the buildings where PTO staff currently work.

PTO is trying to automate and reengineer its operations, such as automating all of its files and testing a pilot work-at-home program for trademark attorneys. These efforts could result in reduced staffing needs and/or decreased space needs in the future. It is clear that PTO’s workload is growing, but it is impossible to predict the long-term effects on PTO’s employment levels because of PTO’s automation and reengineering efforts, its difficulties in hiring employees in today’s competitive market, and the possibilities of a broadly applied work-at-home program and/or the use of satellite sites located closer to the source of the workload.

In addition, we reviewed the June 10, 1999, Business Case Analysis of Space and Facilities Management prepared by DEVA and Associates, PC (DEVA report), which identified the \$72 million in savings over a 20-year period for housing 7,108 staff.¹⁷ This report presented the potential economic differences between remaining unconsolidated and consolidating into one location. DEVA identified 24 cost areas for analysis, including basic rent, dual rent, security, security upgrades, shuttle cost, and lost production time. DEVA attributed the bulk

¹⁷The original DEVA report done in May 1998 was updated in June 1999 in response to a request by the Chairman, Subcommittee on Economic Development, Public Buildings, Hazardous Materials and Pipeline Transportation, House Committee on Transportation and Infrastructure. It was updated to reflect comments made in an Arthur Andersen LLP review of the initial report.

of the potential savings to reducing nonproductive travel time among PTO sites and rent for space for staff increases from 6,400 to 7,100. The methodology and assumptions used to identify the cost savings seemed reasonable.

At our request, DEVA updated its report in November 2000 to reflect recent increases in rent costs. The update showed that the consolidation now has the potential for cost savings of \$98 million over 20 years. The cost savings are estimates, and it is not yet certain how much will actually be saved through the consolidation.

Further, even if no savings occur, the consolidation would enable PTO to provide better security for its staff and meet fire, life safety, and accessibility standards for federal facilities. In June 1995, the Department of Justice (DOJ) issued a report recommending specific minimum security standards, such as controlled parking facilities and use of security according to building occupancy, size, contact with the public, and mission of the agency. PTO currently occupies eight buildings that according to DOJ standards, should have controlled parking facilities and security guards, which, according to a PTO official, are not currently available. The six facilities we visited had limited or no security for the staff housed there and had underground parking to which the public had unrestricted access.¹⁸ In addition, according to GSA, three buildings currently occupied by PTO do not comply with current fire, life safety, and accessibility codes and standards. The new facility, which will be a complex of five interconnected buildings, will allow PTO to implement new security features and ensure that the buildings meet all fire, life safety, and accessibility codes and standards.

Some Building Features, Such as Fitness and Day Care Centers, Have Become Important Recruitment Tools

One public interest group believed that some of the features being proposed for the new PTO facility, such as a health care unit, fitness center, day care center, auditorium, and dual power source capability, although desirable, may not be essential to providing adequate office space for PTO. Because final specifications for the new PTO facility were not completed at the time of our work, we could not assess all the details concerning the features, such as a health care unit and day care and fitness centers, the public interest group has questioned. Nevertheless, these types of features are not unique to PTO and appear to us to be reasonable because these three features have been authorized by law or governmentwide policy for government buildings. Furthermore, the justifications for the other features appeared reasonable because there are a large number of people to be located at the new facility, and the features should help PTO with its mission and in hiring and retaining employees.¹⁹

In keeping with its integrated workplace initiative, GSA is providing PTO, as well as other agencies, tools it will need to develop a workplace that will serve the needs and work practices of its employees and enhance the government's ability to recruit and retain employees. The goal of this initiative is to identify and promote a more comprehensive approach to providing leading-edge workplaces that will assist federal agencies in creating cost-effective, flexible, efficient office environments that enhance productivity and assist in attracting and retaining a quality workforce.

¹⁸We toured six of PTO's current buildings. We found key-card access devices at one location for access to office space, but no such devices at the other five locations. The parking for all the sites was under the buildings and was not restricted by key-card devices or guards.

¹⁹As of March 22, 2001, the City of Alexandria had not yet approved the design of the building.

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PTO's new facility is to provide a number of features, such as a health care unit, fitness center, day care center, auditorium, and dual power source capability. Some of these types of features, such as the health care unit, fitness center, and day care center, are authorized by law or governmentwide policy. Furthermore, according to PTO officials, these features are important because PTO is having difficulty recruiting and keeping employees, and the features may help to alleviate this problem.

Congress has supported health care programs to promote and maintain the physical and mental fitness of government employees since 1946, when it passed the first law authorizing the head of government agencies to spend federal funds for health service programs.²⁰ Under this law, agencies established health units for employee use. Since then, through governmentwide policy, the federal government has supported and encouraged physical fitness and other preventive health care programs as essential elements of an agency's health service program for workers. Further in 1985, Congress authorized federal agencies to establish child care facilities for federal employees.²¹ Currently, GSA has 110 child care centers operating in 32 states and the District of Columbia.

Many organizations, including the Office of Personnel Management, GSA, PTO, and us, believe that such features are important in helping federal agencies recruit and retain employees in a competitive market and help contribute to employee morale and productivity. Further, we found 100 private local buildings plus other federal buildings that provide some of these types of features.

We found that PTO had justified the inclusion of several other building features that one public interest group believed were unnecessary. For example, according to a PTO official, the auditorium is needed to hold large staff meetings, briefings for the public, and other conferences, and meetings that cannot be handled by a conference room. Without the auditorium, PTO would have to rent space to hold these various meetings, as it does now. Further, PTO believes that the auditorium supports GSA's policy under the Public Buildings Cooperative Use Act of 1976 to support the surrounding community by providing a facility for arts and community use.²²

Also, a PTO official told us that PTO wants dual power source capability from separate substations to support its automation efforts. PTO has begun to accept patent and trademark applications over the Internet and has plans to maintain the official copies of these applications on computers rather than retain paper copies. Therefore, a loss of power could bring PTO's operations to a halt and prevent it from serving its customers in a timely manner. Having an alternative power source should reduce the possibility of this occurring. Further, in its review of the record in a civil action concerning PTO, a federal court confirmed PTO's need for dual power on the basis of the Court's review of the administrative record.²³

²⁰5 U.S.C. 7901.

²¹40 U.S.C. 490b.

²²40 U.S.C. 601a.

²³U.S District Court for the Eastern District of Virginia, Civil Action #98-1.

Funding Planned for Tenant Improvements Did Not Appear Excessive and a Competitive Furniture Procurement Appears to Offer the Best Value

The public interest group believed that the standard tenant improvement allowance and planned furniture acquisition are excessive. It also suggested that there may not be a cap on the amount that can be spent on interior finishes in the new PTO facility. GSA has provided an \$88 million tenant improvement allowance for PTO's new facility, and PTO plans to spend another \$29 million for above-standard improvements. The combined \$117 million in tenant improvement allowance does not seem excessive. The public interest group apparently misunderstood what comprises GSA standard tenant improvement allowance. PTO also plans to spend, if appropriated, \$64 million for furniture. Although the final details for these items had not been completed, the information currently available on the types of items PTO plans to buy and the fact that it is a planned competitive procurement do not support the conclusion that the planned expenditures are excessive. PTO considers the amount to be spent on interior finishes for the PTO facility to be capped at \$29 million.

Tenant Improvement Allowance

We found that the public interest group had apparently misunderstood what comprises GSA's tenant improvement allowance when it said the allowance was excessive. First, the group identified \$125 million as the amount established for the standard tenant improvement allowance. We were able to identify only \$117 million—GSA's \$88 million tenant improvement allowance plus the \$29 million to be funded by PTO directly for its specific needs—for items that are typically considered tenant improvements.²⁴ Although PTO does plan to spend additional funds for its consolidation over and above what GSA is providing under the lease, these costs are not part of GSA's or PTO's "tenant improvement allowance."²⁵

Second, GSA's standard tenant improvement allowance, which is generally used to convert existing space to a new tenant's needs, provides funds for such items as floor coverings, interior partitions, ceilings, and interior doors. PTO's \$88 million allowance—\$44.24 per OSF—provides funds (about \$38.30 per OSF) for these same finishes plus funds (about \$5.94 per OSF) for all branch and secondary distribution systems for mechanical and electrical services through the office areas and joint use space.²⁶ According to a GSA official, the cost for mechanical and electrical services usually ranges from \$10 to \$15 per OSF. Consequently, one could reasonably expect the per OSF allowance to be between \$48 to \$53; thus, the

²⁴ We believe that the \$8 million comes from the \$135 million in space consolidation costs, but we could not identify a specific item with which to associate it.

²⁵ PTO's planned space consolidation costs total about \$135 million. In addition to PTO's \$29 million tenant improvement allowance, these space consolidation costs include \$64 million for furniture, \$17 million for information technology and signage, \$7.8 million for dual rent, \$6.9 million for program management, \$5.5 million in moving expenses, and \$5 million in security upgrades. The figures do not total to \$135 million because of rounding. PTO reports quarterly to its Senate appropriations subcommittee on the status of all of its space consolidation costs.

²⁶ The standard tenant improvement allowance is calculated using the base rate of \$31.92 per usable square foot (approximately equal to an occupiable square foot) for the Washington, D.C., area for fiscal year 2000. This amount is then multiplied by a specific factor on an agency-by-agency basis. In this case the PTO factor is 1.2. This results in a standard tenant improvement allowance for PTO of \$38.30. It is unclear how the public interest group obtained the figure \$36.69 for the standard tenant improvement allowance.

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\$44.24 allowance does not appear to be excessive. According to GSA officials, it is the lessor's responsibility to provide all the agreed-upon standard improvements for \$88 million. Third, the \$29 million in above-standard tenant improvements is not part of GSA's standard tenant improvement allowance. PTO has prepared a written justification for the types of additional items it wants in the facility. The \$29 million represents funds for what are known as above-standard finishes, which, in PTO's case, include such items as slab-to-slab partitions with a sound transmission coefficient of 45 for sound control and security; locks on office doors; upgraded carpets in public areas; and special heating, ventilating, and air conditioning for the conference rooms. Agencies often seek separate funds from Congress to pay for these above-standard items as well as for other space consolidation-related costs, such as moving expenses, that are over and above GSA's standard tenant improvement allowance. PTO told us that the above-standard improvement allowance for the PTO facility is capped at \$29 million. At the time we did our fieldwork, the detailed specifications for the above-standard items were not completed.

Planned Furniture Acquisition

PTO plans to use a competitive procurement to obtain its furniture needs, which should result in the best price for the quality. The public interest group believed that the furniture expected to cost about \$64 million identified in the DEVA report may be overpriced. Although PTO had not yet made final decisions on all of its planned furniture acquisition when we completed our fieldwork, the process it was going through to select and acquire the furniture generally appeared to be aimed at achieving the best value for the government. According to a PTO official, furniture costs are capped at \$64 million.

Because of the amount of furniture needed, such as office furniture and workstations for a potential 7,000 staff, and in an effort to obtain the best value possible, PTO has decided to compete the requirements rather than buying directly from the GSA Furniture Schedule. PTO issued a Request For Information on furniture costs and received 24 responses from furniture manufacturers. PTO then decided to create a showroom to have manufacturers display their products for staff review and comment.²⁷ Thirteen manufacturers participated, and PTO evaluated the responses to an employee survey on the various products. According to a PTO official, as of April 10, 2001, PTO has finalized its specifications for a Request for Proposal (RFP) and would like to conduct the furniture procurement on a best value basis so that both quality and cost can be considered. PTO officials believe that a competitive procurement will allow them to obtain both high quality and a good price.

However, prior to issuing the competitive RFP, PTO will have to seek and obtain a waiver, which it is in the process of doing, from Federal Prison Industries (FPI), from which federal agencies are required to purchase products if they meet the buying agencies' requirements and the prices charged do not exceed current market prices. If PTO does not receive a waiver from FPI, it is not known whether FPI can provide the best value; however, PTO would be required by law to purchase the furniture from FPI.²⁸ PTO has identified 19,347 items, or 13 percent of its inventory, suitable for relocation on the basis of condition and ergonomic quality. PTO has received some initial funding for furniture but plans to ask for most of the

²⁷When PTO revised its cost analysis in June 2000, it showed furniture costs rising to about \$67 million. According to a PTO official, this was a result of updating information in the model without adjusting the model to reflect furniture costs being capped at about \$64 million.

²⁸18 U.S.C. 4124

funding in the next 2 fiscal years—\$16 million in fiscal year 2002 and \$42.9 million in fiscal year 2003.

Construction of the PTO Facility Would Have Been Less Costly but Was Not a Viable Option

We have stated in reports issued in 1997 and 1999 that construction would have been an estimated \$48 million less costly than leasing space for PTO.²⁹ The public interest group says that GSA should have constructed the PTO facilities with appropriated funds because it would be less costly to the government. However, according to PTO's Administrator of Space Acquisition, at the time of the prospectus, the administration and PTO's appropriation committees agreed that a competitive lease was the only viable option because neither user fees nor taxpayer funding were available to construct or purchase a new PTO facility.

We have previously reported that the budget scoring rules favor leasing and that one option for scorekeeping that could be considered would be to recognize that many operating leases are used for long-term needs and should be treated on the same basis as purchases.³⁰ This would entail scoring up front the present value of lease payments covering the same time period used to analyze ownership options. Applying the principle of up-front full recognition of long-term costs to all options for satisfying long-term space needs—purchases, lease-purchase or operating leases—is more likely to result in selection of the most cost-effective alternative than the current scoring rules would.

²⁹*Space Acquisition Cost: Comparison of GSA Estimates of Three Alternatives* (GAO/GGD-97-148R, Aug. 6, 1997). *General Services Administration: Comparison of Space Acquisition Alternatives—Leasing to Lease-Purchase and Leasing to Construction* (GAO/GGD-99-49R, Mar. 12, 1999).

³⁰*Budget Issues: Budget Scorekeeping for Acquisition of Federal Buildings* (GAO/T-AIMD-94-189, Sept. 20, 1994.)

Scope and Methodology

To address the allegations concerning the procurement process, we reviewed the SFO, laws and court cases addressing the PTO lease, and GSA and DOC Inspector General reports. For the concerns about the lease itself, we reviewed the SFO; Program of Requirements; the lease; the independent appraisal; the facility's location; GSA IG reports; OMB's guidance on scoring a lease (Circular A-11 Appendix B, and Circular A-94); GSA's construction cost estimating guidance; GSA's calculation of FMV of the property; and GSA's scoring of the lease. Also, we interviewed both OMB and GSA officials concerning this issue. For the concerns about space needs, we reviewed various documents PTO prepared concerning staffing, workload, automation, and reengineering; visited six of PTO's office locations; reviewed the DEVA report and its assumptions; reviewed two consultant reports that reviewed the DEVA report; and interviewed PTO staff. Further, we had DEVA update the report to reflect current changes in the rent. For the concern about nonessential requirements in the lease, we reviewed laws, searched CoStar, a computerized listing of all commercial space in GSA's National Capital Region, and interviewed PTO and GSA officials concerning the issue. For the concerns about the tenant allowance and furniture costs, we reviewed the laws, SFO, Request for Information, and various other documents concerning furniture needs and interviewed GSA and PTO officials. For the concern about building versus leasing, we reviewed prior GAO products and the lease.

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