



United States General Accounting Office
Washington, DC 20548

July 11, 2002

The Honorable Christopher Shays
Chairman
Subcommittee on National Security,
Veterans Affairs, and International Relations
Committee on Government Reform
House of Representatives

Subject: *Current Law Limits the State Department's Authority to Manage Certain Overseas Properties Cost Effectively*

Dear Mr. Chairman:

The Department of State is the central manager for real estate at U.S. embassies and consulates and has the statutory authority to sell properties and use the sales proceeds to acquire and maintain other overseas properties. Section 738 in the fiscal year 2001 Agriculture Appropriations Act prohibits State from selling residences purchased to house agricultural attachés without approval from the Foreign Agricultural Service (FAS) and requires the department to use the proceeds from such sales to purchase residences for these attachés.¹ Legislation currently before the Congress would repeal section 738.²

At your request, this report discusses the effect of section 738 on State's management of overseas properties. We examined this issue as part of our review of the Department of State's performance in identifying and selling unneeded overseas real estate.³ In conducting this assignment, we interviewed officials and analyzed records at the Department of State, FAS, and the Office of Management and Budget (OMB).

Results in Brief

Section 738 limits the Department of State's authority to implement cost-effective decisions about sales of unneeded overseas property and the use of sales proceeds.

¹P.L. 106-387, section 738, 114 stat. 1549A-34.

²Both the Senate and House versions of the fiscal years 2002 and 2003 Foreign Relations Authorization Act contain language repealing section 738. See S. 1401, section 207, and H.R. 1646, section 205.

³See U.S. General Accounting Office, *State Department: Sale of Unneeded Property Has Increased but Further Improvements Are Necessary*, [GAO-02-590](#) (Washington, D.C.: June 11, 2002).

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Because of section 738's restrictions, State has delayed two property sales valued at nearly \$4 million that appear to be in the government's best interests. FAS is concerned that if section 738 is repealed, selling these properties will result in increased costs for FAS since it would have to lease housing for attachés who previously lived rent-free in government-owned housing. State acknowledges that this could occur but says its financial analysis shows that selling the houses benefits the government as a whole. Although section 738 applies only to residences purchased for agricultural attachés, OMB and State are concerned that it could lead to fragmented and less cost-effective management of overseas property if other agencies seek similar treatment for their senior representatives. In our view, section 738's restrictions do not appear to be in the government's best interests.

This report suggests that the Congress may wish to consider repealing section 738. State officials, commenting on a draft of this report, said they agreed with the report's information and conclusions regarding the negative effects of section 738 on overseas property management. FAS officials reiterated their view that repealing section 738 could result in increased costs for FAS. We believe that if the section's repeal and sale of residences used by agricultural attachés increases FAS costs, the Department of Agriculture can request that the Congress consider providing additional funds for FAS operations.

Background

The Foreign Buildings Act of 1926, as amended, authorizes the Secretary of State to sell overseas properties that are used to support diplomatic and consular operations in foreign countries.⁴ The Department of State manages about 3,500 government-owned properties—including embassy and consular office buildings, housing, and land—at more than 220 overseas locations. The law authorizes the Secretary to use the proceeds from the sale of overseas properties to acquire and maintain other overseas properties and requires the Secretary to report such transactions to the Congress with the department's annual budget estimates. The Secretary has delegated this authority to State's Bureau of Overseas Buildings Operations.⁵

Over the years, as a result of congressional and OMB actions, overseas property management has been consolidated under State.⁶ In 1978, the Congress endorsed State as the single manager for overseas property and asked OMB to prepare a proposal for implementing this concept.⁷ In 1979, OMB issued a report that supported the concept of single management and acquisition planning for overseas property under State.⁸ OMB noted that the Congress was strengthening and

⁴22 U.S.C. section 300, as amended.

⁵Prior to May 2001, this bureau was known as the Office of Foreign Buildings Operations.

⁶State's authority does not encompass overseas property under the control of U.S. military commanders. Additionally, the U.S. Agency for International Development has authority to manage property at some overseas locations.

⁷See the Conference Report on the Foreign Assistance appropriations act for fiscal year 1979, H.R. (Conf.) 95-1754, at 13 (1978).

⁸U.S. Office of Management and Budget, *Office of Management and Budget Report: Single Manager Concept for Acquisition of U.S. Real Estate Overseas* (Washington, D.C.: Jan. 1979).

broadening State's existing role as the central manager for overseas property. In 1990, the Congress directed State to establish and implement a uniform housing policy for agencies' overseas personnel.⁹ Resulting new overseas housing regulations, issued in 1991 and 1992 with the agreement of the foreign affairs agencies¹⁰ and the Department of Defense, reinforced State's authority to act as the single manager for overseas property. These authorities show that the Congress and the executive branch had intended that State should manage overseas property in a consolidated, integrated manner and that doing so would be in the government's best interests. We have supported this concept since the 1960s because it is more effective, efficient, and economical than having multiple property managers.¹¹

Since 1997, State has increased efforts to identify and sell unneeded overseas real estate in response to congressional direction and our recommendations.¹² As part of this effort, State sold two residences occupied by agricultural attachés for about \$855,000 and proposed selling three others for more than \$4 million.¹³ FAS argued that these properties were purchased to house its attachés; and consequently, FAS should have a say in approving the sales and in determining how the sales proceeds should be used. As a result, FAS sought and the Congress enacted legislation that requires State to obtain FAS approval to sell residences purchased to house agricultural attachés. Additionally, State must use the proceeds from such sales to acquire other suitable residences for agricultural attachés (not necessarily at the same post), and FAS has the right to occupy these properties permanently. According to FAS, State manages 13 properties purchased for agricultural attachés.

Section 738 Limits State's Authority to Make Cost-Effective Decisions on Certain Properties

Section 738 of the fiscal year 2001 Agriculture Appropriations Act limits State's authority to sell unneeded property by making sales decisions contingent on FAS approval. Proposed sales of residences in Cairo, Egypt, and Vienna, Austria, illustrate the potential limitations. Although selling these properties appears to be in the U.S. government's best interests, State has postponed these sales because of concerns about section 738. In October 1998, the State Inspector General reported that the Cairo and Vienna residences were larger than housing standards allow, were underutilized, and should be sold. According to State records, the Cairo residence is

⁹P.L. 101-246, section 156, 104 Stat. 46.

¹⁰The foreign affairs agencies are the Department of State, FAS, the U.S. and Foreign Commercial Service, and the U.S. Agency for International Development.

¹¹See, for example, U.S. General Accounting Office, *Improvements Needed in the Management of Government Owned and Leased Real Property Overseas*, B-146782 (Washington, D.C.: Sept. 30, 1969) and *Some Progress in Improving Management of Government Owned and Leased Real Property Overseas*, B-146782 (Washington, D.C.: Mar. 28, 1974).

¹²See U.S. General Accounting Office, *Overseas Real Estate: Millions of Dollars Could Be Generated by Selling Unneeded Real Estate*, [GAO/NSIAD-96-36](#) (Washington, D.C.: Apr. 23, 1996) and [GAO-02-590](#).

¹³State sold residences in Rabat, Morocco, and Santiago, Chile. State proposed selling residences in Cairo, Egypt; Stockholm, Sweden; and Vienna, Austria. State has since decided not to sell the Stockholm residence at this time because of changed financial conditions.

a 4,200-square-foot,¹⁴ two-level house with four bedrooms, three bathrooms, two living rooms, a dining room, two kitchens, a sunroom, a breakfast room, and terraces. The Vienna residence is a 3,500-square-foot,¹⁵ three-story villa with six bedrooms, three bathrooms, a terrace, breakfast room, basement, and garage. These residences are larger than the housing standards allow.¹⁶ Figures 1 and 2 show photographs of the Cairo and Vienna residences.

Figure 1: Cairo Residence (side view)



Source: GAO.

¹⁴The reported figure is the net living area, excluding halls, foyers, closets, laundry rooms, servants' quarters, and storage. According to State records, the Cairo residence has a gross living area of about 6,700 square feet.

¹⁵The reported figure is the net living area. According to State records, the Vienna residence has a gross living area of about 6,400 square feet.

¹⁶The *Foreign Affairs Manual* states that the size of housing for the heads of foreign affairs agencies and Defense will be based on a family of four. For Cairo, the housing standards allow 2,957 square feet for an executive family of four. For Vienna, the standards allow 2,146 square feet.

Figure 2: Vienna Residence (rear view)



Source: Department of State.

State financial analyses suggest that selling the Cairo and Vienna residences would yield net benefits for the government of at least \$2.1 million.¹⁷ In addition, using a measure of investment performance, State determined that selling the two residences was a substantially more efficient use of government resources than continued ownership.¹⁸ In February 2001, FAS informed State that it approved the sale of the Vienna residence on condition that the sales proceeds were used to purchase a replacement residence in Vienna and new residences for agricultural attachés at two other posts.¹⁹ Because FAS's proposed use of the proceeds would not address the government's highest priority overseas property needs, State officials decided to postpone the Vienna sale pending repeal of section 738. State subsequently postponed the Cairo sale for the same reason.

¹⁷Net financial benefits are computed by subtracting the cost of purchasing or leasing replacements over a 10-year period from the estimated value of the properties. State's computations included the cost of leasing replacement properties in Cairo and Vienna over 10 years.

¹⁸According to OMB Circular No. A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs* (Washington, D.C.: Oct. 29, 1992), investment performance can be analyzed by comparing the internal rate of return of continued ownership of an asset with an interest rate approximating the cost of government funds. For example, an internal rate of return substantially below the cost of funds suggests that it would be in the government's best interest to sell the asset. For the Cairo and Vienna properties, the internal rate of return for continued ownership was substantially below the government's cost of funds.

¹⁹These posts were Pretoria, South Africa, and Mexico City, Mexico. FAS also asked that State use part of the proceeds to perform maintenance on the residence in Stockholm.

State and OMB believe that the sales proceeds should be used to meet the government's highest priority needs. According to its long-range facilities plan, State seeks to reinvest sales proceeds where there is the greatest need or the most opportunity to reduce government operating costs. This plan notes that, in recent years, most sales proceeds have been earmarked for specific capital construction projects, such as building secure embassies. In future years, State plans to use sales proceeds to purchase additional residential housing. Within this broad priority, State plans to direct these proceeds to several objectives: (1) buying residential properties in locations that offer the greatest rent savings to contain leasing costs, (2) buying earthquake resistant residential properties in seismic areas to address safety issues, and (3) buying key diplomatic properties. Although we did not assess State's priorities or use of proceeds from property sales, its approach is consistent with recommendations we made in 1996 regarding using sales proceeds for the highest priority overseas facility needs.²⁰

FAS believes that the sales proceeds should be used to purchase replacement and additional residences for agricultural attachés—not to purchase properties according to State's priorities. FAS said that past sales had displaced two of its attachés from government-owned housing, forcing it to pay about \$400,000 over the past 5 years to lease replacement residences. FAS is concerned about having to cut its program budgets to fund additional leases for replacement housing. In addition, FAS complained that it had insufficient advance notice of the proposed sales and had difficulty freeing up funds to pay for replacement housing for displaced attachés.

State acknowledged that FAS may have to lease replacement residences if section 738 is repealed and the two residences are sold. However, financial analyses of the proposed sales considered these costs in determining that they were cost effective for the government. State also acknowledged that unanticipated sales could cause short-term budgetary disruptions. As a result, in June 2001, assuming repeal of section 738, State offered to pay for leasing replacement housing until FAS could build these costs into its budget in cases where State disposed of the properties with less than 2 years' advance notice. In January 2002, FAS responded that, before agreeing to any sales, it would require State to provide appropriate government-owned replacement housing within 2 years and expect State to make every effort to ensure that sales did not affect FAS's budget. FAS's letter did not address the repeal of section 738. In April 2002, FAS officials told us they were reluctant to accept State's offer because it did not address the long-term budgetary effect of the sales and allowed State to retain control over the use of the sales proceeds.

According to State, if section 738 remained in effect, it could be a complicating factor in the future sale of a compound in downtown Bangkok that could be worth as much as \$50 million. In 1998, the State Inspector General reported that the compound—a 15-acre wooded site located in a prime commercial area that contains five executive residences (one occupied by the agricultural attaché) and several other facilities—was underutilized and should be sold. Before the 1997 Asian financial crisis, State had planned to sell the compound and use the proceeds to finance the construction

²⁰See [GAO/NSIAD-96-36](#).

of new facilities at the post, including housing for more than 200 embassy families that would reduce post lease costs by about \$73 million over 10 years. Recognizing the changed economic conditions, State reported that further study is needed to determine the appropriate time to sell the compound and the appropriate use of the sales proceeds.

State and OMB Support Repealing Section 738; FAS Opposes Its Repeal

State and OMB support legislation currently before the Congress that would repeal section 738.²¹ They argue that its restrictions on State's authority seriously weaken centralized management of overseas properties because they essentially establish a separate executive housing program for FAS and subordinate governmentwide priorities to agency priorities. For example, FAS could disapprove the sale of oversize or high-value residences purchased for agricultural attachés while State was selling residences purchased for ambassadors, deputy chiefs of mission, consuls general, and senior representatives of other foreign affairs agencies. State reported that, between 1997 and 2002, it sold 17 executive residences for about \$38 million and is planning to sell 15 additional residences for \$20 million.²² Additionally, State and OMB pointed out that other foreign affairs agencies and Defense have experienced budgetary effects from the sale of such residences. In these cases, agencies must weigh housing costs in deciding whether to station their employees overseas. State and OMB are also concerned that unless section 738 is repealed, other agencies may seek similar legislation, leading to more fragmented property management and unequal and uneconomical housing policies at taxpayer expense.

FAS opposes repealing section 738. FAS argues that section 738 maintains Agriculture's entitlement to residences purchased to house its attachés. FAS believes that repealing section 738 would allow State to ignore what FAS believes was the Congress' intent in providing funds to purchase these residences, while imposing substantial budgetary costs on FAS.

Conclusions

Section 738's restrictions on the sales of residences purchased for agricultural attachés do not appear to be in the government's best interests. As the single manager for overseas property, State is responsible for implementing cost-effective decisions about the sale of unneeded overseas real estate and using sales proceeds for the government's highest priorities. However, for residences purchased to house agricultural attachés, implementation of State's decisions is contingent on FAS approval and priorities. Although its analysis shows that selling the Vienna and Cairo residences would be financially advantageous to the government, State does not plan to proceed with these sales if section 738 remains in force. We recognize that, if

²¹S. 1401, section 207, and H.R. 1646, section 205.

²²In June 2002, we reported that over this period, State had sold a total of 104 overseas properties for more than \$404 million and had identified 92 additional properties, valued at more than \$180 million, as candidates for sale. See [GAO-02-590](#).

section 738 is repealed, selling these residences may affect FAS's budget. However, FAS's budgetary concerns need to be weighed against the government's overall benefits from these sales—which include disposing of unneeded property and reinvesting the proceeds where they provide the greatest return. In addition, the restrictions weaken efforts to improve management of the government's overseas properties and conflict with congressional and executive branch efforts to establish State as the single real property manager.

Matter for Congressional Consideration

In light of our findings, Congress may wish to consider repealing section 738 of the fiscal year 2001 Agriculture Appropriations Act.

Agency Comments and Our Evaluation

State officials, commenting on a draft of this report, said the report fairly and accurately represents their positions on the negative effects of section 738 and the reasons they support its repeal. They said it is in the government's interest to have a single property manager with the authority to sell unneeded properties and reinvest the proceeds where they will produce the greatest benefits. State officials reiterated their concern that, by according FAS special treatment, section 738 threatens the centralized management of overseas property and is unfair to the staff of other foreign affairs agencies and Defense.

FAS officials reiterated their concern that repealing section 738 could result in additional annual lease costs for FAS and that FAS would need additional budget resources to maintain its current level of services overseas. FAS officials also questioned whether section 738 would fragment overseas property management, stating that only Defense was in a position to assert similar claims to overseas housing.

We continue to believe that, in considering whether to repeal section 738, budgetary concerns need to be weighed against the government's interests in selling these residences and maintaining a single property manager with the authority to sell unneeded properties and reinvest the proceeds where they will produce the greatest benefits. If the section's repeal and subsequent property sales increase FAS costs, Agriculture can request that the Congress consider providing more funds for FAS operations. Additionally, we agree with State that section 738 accords FAS preferential treatment and that other foreign affairs agencies and Defense will likely seek similar treatment for their overseas executives. We believe this would weaken centralized overseas property management, which we have long supported because it is more effective, efficient, and economical than a noncentralized approach.

Scope and Methodology

To determine the effect of section 738 on State's management of overseas property, we analyzed applicable laws, regulations, and guidance that provide State's authority to sell properties and use the proceeds. Key laws, regulations, and guidance include the Foreign Buildings Act, section 738 of the fiscal year 2001 Agriculture

Foreign Affairs Manual. We also examined past GAO and State Inspector General reports on overseas property management. We analyzed State and FAS records that summarized their assessment of the effect of section 738 on State's authority to buy and sell overseas properties and act as the single manager for overseas property. We discussed section 738's effect with appropriate State, FAS, and OMB officials. We examined State's rationale for selling the properties in Cairo, Vienna, and other locations, including State's financial analyses of the proposed sales, OMB guidance on evaluating asset sales, and State's fiscal year 2002 to 2007 long-range overseas buildings plan. We did not assess the accuracy or reliability of the property appraisals or other underlying data used in State's analyses or the priorities and objectives in its long-range plan.

We conducted this review from April to July 2002 in accordance with generally accepted government auditing standards.

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We are sending copies of this report to other interested congressional committees, the Secretaries of Agriculture and State, the FAS Director, State's Director of Overseas Buildings Operations, OMB, and other interested parties. Copies will be made available to others on request. In addition, this report will be available at no charge on our Web site at <http://www.gao.gov>.

If you have any questions about this report, please contact me at 202-512-4128 or by e-mail at fordj@gao.gov. John Brummet, Michael Rohrback, Ed Kennedy, Richard Seldin, Janey Cohen, and Stephanie Robinson made major contributions to this report.

Sincerely yours,

A handwritten signature in black ink that reads "Jess T. Ford". The signature is written in a cursive style with a large, looping initial "J".

Jess T. Ford
Director, International Affairs and Trade