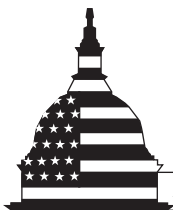


June 2011

DEFENSE INFRASTRUCTURE

The Enhanced Use Lease Program Requires Management Attention



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Report Documentation Page				Form Approved OMB No. 0704-0188	
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1. REPORT DATE JUN 2011		2. REPORT TYPE		3. DATES COVERED 00-00-2011 to 00-00-2011	
4. TITLE AND SUBTITLE Defense Infrastructure: The Enhanced Use Lease Program Requires Management Attention				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) U.S. Government Accountability Office, 441 G Street NW, Washington, DC, 20548				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 68	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

DEFENSE INFRASTRUCTURE

The Enhanced Use Lease Program Requires Management Attention

Why GAO Did This Study

To help address challenges associated with deteriorating facilities and underused property, the Department of Defense (DOD) has pursued a strategy that includes leasing underused real property to gain additional resources for improving installation facilities. Section 2667 of Title 10, U.S. Code, provides authority to the military departments to lease nonexcess real property, subject to several provisions, in exchange for cash or in-kind consideration. According to the military services, some leases, referred to as enhanced use leases (EUL), are more complex with long terms and could provide hundreds of millions of dollars for in-kind services to improve installation facilities.

A committee report accompanying the 2011 defense authorization directed GAO to review the EUL program. This report (1) assesses the extent to which selected EULs complied with section 2667 of Title 10, U.S. Code; (2) determines to what extent the services' expectations for their EULs have been realized; and (3) evaluates the services' management of the EUL program. GAO reviewed information on the services' 17 EULs in place at the end of fiscal year 2010 and selected 9 for detailed case study.

What GAO Recommends

GAO recommends that DOD take several actions to address EUL statutory compliance issues and EUL management weaknesses. DOD agreed with all of GAO's recommendations.

View [GAO-11-574](#) or key components. For more information, contact Brian J. Lepore, at (202) 512-4523 or leporeb@gao.gov.

What GAO Found

One of the Army EULs included in the GAO case studies did not comply with the EUL authorizing statute, section 2667 of Title 10, U.S. Code. In March 2011, GAO issued a legal opinion finding that certain terms and conditions of the legal documents comprising the Army's Picatinny Arsenal EUL violated section 2667(e) and the miscellaneous receipts statute by failing to require that cash consideration be deposited into the appropriate account of the U.S. Treasury. Instead, the cash was deposited into an escrow account at a local credit union. Also, while no two EULs are identical, GAO found that the two other Army and the three Air Force case study EULs included some terms and conditions similar to those that were found to be problematic by the legal opinion, which raised questions about the extent to which such EULs also comply with the statutory requirements. Moreover, beyond those issues addressed in the legal opinion, GAO found that three Army and one Air Force case study EULs did not comply with another provision in section 2667, which requires that each lease executed pursuant to section 2667 provide that if and to the extent that the leased property is later made taxable by state or local governments under an act of Congress, the lease shall be renegotiated.

The services' expectations for EUL development timeframes and financial benefits were not realized in two Army and one Air Force EULs included in the GAO case studies largely because, according to the services, the recent economic downturn caused EUL development plans to significantly slow down or to be placed on hold. To illustrate, in the Fort Sam Houston EUL that was signed in 2001, only two of the three large deteriorated buildings included in the lease have been renovated, and the Army now estimates that EUL consideration will be about 22 percent less than was originally estimated. Moreover, in this case, the Army, rather than private sector tenants as was originally planned, has rented most of the EUL space that has been renovated. Thus, Army officials stated that nearly all of the estimated future consideration is now expected to be the result of the Army getting back a portion of the rent that the Army pays to the EUL developer.

The services' management of the EUL program included weaknesses related to internal controls and program guidance. First, because the services generally lacked documentation showing how certain provisions contained in the authorizing statute were addressed, it was not clear to what extent the services addressed each provision before entering into the leases. Second, in some EUL cases, it was not clear how and to what extent the services ensured the receipt of the fair market value of the lease interest, as required by the authorizing statute. Third, some EULs included property that was being used or might be needed by the military over the lease term, which could result in increased costs to relocate military activities or increased potential costs, if a lease had to be terminated early to permit the military to regain control of the property. Fourth, the services were not regularly monitoring EUL program administration costs, as called for by internal control standards, to help ensure that costs were in line with program benefits.

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Abbreviations

BRAC	base realignment and closure
DOD	Department of Defense
EUL	enhanced use lease
FMV	fair market value

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United States Government Accountability Office
Washington, DC 20548

June 30, 2011

Congressional Committees

With a real estate portfolio of over 539,000 facilities and 28 million acres of land, the Department of Defense (DOD) has been challenged to effectively manage deteriorating facilities and underused and excess property.¹ To address these challenges, DOD has pursued a multipart strategy involving base realignment and closure (BRAC), housing privatization, and demolition of facilities that are no longer needed. In addition, DOD has also pursued a strategy of leasing underused real property to gain additional resources for the maintenance and repair of existing facilities or the construction of new facilities. For example, subject to provisions contained in section 2667 of Title 10, U.S. Code, the secretaries of the military departments have the authority to lease nonexcess real property² under the control of the respective departments in exchange for cash or in-kind consideration that is not less than the fair market value (FMV) of the lease interest.³ Among other things, in-kind consideration accepted with respect to a lease under this section can include the maintenance of existing facilities or the construction of new facilities.

The military services have long used the authority under section 2667 to enter into short-term leases⁴ of military property for such uses as farming,

¹Land that DOD classifies as underused or not utilized may not necessarily be considered excess property. Pursuant to section 102(3) of Title 40, U.S. Code, excess property is defined as property under the control of a federal agency that the head of the agency determines is not required to meet the agency's needs or responsibilities. Therefore, a parcel of DOD real property could potentially be underused yet still not be excess because it is required to meet certain DOD needs or responsibilities. For example, land at the perimeter of an installation may be unused but not considered excess because the land serves as a buffer zone between military and civilian activities.

²While section 2667 may be used for personal property, we only examined leases of real property for the purposes of this report.

³Hereinafter, we use "military services" to refer to the Secretaries of the Army, Navy, and Air Force. Further, while the Secretary of Defense is authorized to use this authority with respect to matters concerning the defense agencies, officials from the Office of the Secretary of Defense told us that no enhanced use leases have been executed by the Secretary of Defense.

⁴The services generally consider leases with terms of 5 years or less to be short-term leases. For the purposes of this report, "short-term leases" refers to leases executed pursuant to section 2667 that have a term of 5 years or less.

grazing, and cellular towers, and in turn received cash consideration. The services have also used the authority contained in the statute to enter into more complex leases that the services refer to as enhanced use leases (EUL).⁵ EULs generally provide for in-kind consideration, and some EULs involve complex agreements and long terms. For example, an EUL might provide for a 50-year lease of military land to a private developer that would be expected to construct office or other commercial buildings on the land and then rent the facilities to private sector tenants for profit. As consideration, the military might receive cash or in-kind services valued at an amount equal to a share of the net rental revenues from the developed property.

According to the military services, EULs offer significant opportunities to reduce infrastructure costs. Over the terms of some EULs, the services have estimated that they would receive in-kind consideration valued at hundreds of millions of dollars that would be used to improve installation facilities. As of the end of fiscal year 2010, the services reported that 17 EULs were in place—the Army reported 7, the Navy reported 5, and the Air Force reported 5. The services also reported that 37 additional EULs were in various phases of review or negotiation for possible future implementation.⁶

In its report accompanying H.R. 5136, National Defense Authorization Act for Fiscal Year 2011, the House Committee on Armed Services identified potential issues concerning the EUL program and directed that we perform a review of the program, including the extent to which the authorities in section 2667 have been used and expected benefits have been realized.⁷ In response, this report (1) assesses the extent to which selected EULs complied with section 2667,⁸ (2) determines to what extent

⁵Section 2667 does not use “enhanced use lease” to differentiate leases executed pursuant to this authority.

⁶In a November 2010 memorandum, the Army cited our then ongoing review and suspended work on existing and developing EUL projects, pending completion of an internal review of the Army’s EUL program that was to be informed by the findings and recommendations from our review.

⁷Report no. 111-491.

⁸The fact that this report does not specifically address a particular issue in a specific EUL or in a service’s EUL program does not constitute tacit approval of the EUL or other aspects of the service’s EUL program, policies, or practices, nor does it preclude further GAO legal analysis of such EULs and programs.

the services' expectations for their EULs have been realized, and (3) evaluates the services' management of the EUL program.

To address these areas, we reviewed statutory requirements; examined military service policies, instructions, and other guidance related to ensuring statutory compliance; and interviewed officials from the Office of the Secretary of Defense, the Army, the Navy, and the Air Force to discuss efforts to ensure compliance. While we reviewed information on all 17 EULs in place at the end of fiscal year 2010, to specifically assess EUL compliance with statutory requirements, we selected 9 of the 17 EULs for detailed case study review. The EULs were selected nonrandomly to include 3 from each service and a range of lease purposes, estimated financial benefits, and geographic locations.⁹ In each case study, we obtained, reviewed, and compared the lease agreements and related documentation with statutory requirements in place at the time the respective agreements were signed, as well as applicable case law, to assess compliance. To determine the realization of service EUL expectations, we summarized EUL program status information obtained from the services, including data on each EUL's estimated and actual development time frames and financial benefits received through September 30, 2010. For the nine EUL case studies, we obtained and reviewed more detailed information on how the services initially estimated expected EUL financial benefits and how the expected benefits compared with actual benefits obtained to date and, in cases where expected benefits were not realized, explored the reasons why. Further, we reviewed the services' policies, guidance, and practices for managing the EUL program and, for the nine case studies, examined how the services documented fulfillment of certain section 2667 provisions, provided for the receipt of the FMV of the leased property, and considered whether leased property might be needed for military purposes over the lease term. Finally, we compared the services' EUL program administration costs with EUL consideration received through September 30, 2010, and reviewed how the services monitored program administration costs in relation to program benefits.

⁹The three Army EUL case studies were located at Aberdeen Proving Ground, Maryland; Fort Sam Houston, Texas; and Picatinny Arsenal, New Jersey. The three Navy EUL case studies were located at Naval Base Point Loma, California; Naval Base San Diego, California; and Naval Base Ventura County, California. The three Air Force EUL case studies were located at Eglin Air Force Base, Florida (two EULs), and Hill Air Force Base, Utah.

We conducted this performance audit from May 2010 to June 2011 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. Further details on our scope and methodology can be found in appendix I.

Background

Section 2667 of Title 10 provides authority to secretaries of the military departments to lease nonexcess real property¹⁰ under the control of the respective departments, subject to several provisions.¹¹ For example, such leases must be considered by the respective secretary to be advantageous to the United States and include terms that the respective secretary considers will promote the national defense or be in the public interest. In addition, each lease may not be for more than 5 years, unless the secretary concerned determines that a lease for a longer period will promote the national defense or be in the public interest; shall permit the secretary to revoke the lease at any time, unless the secretary determines that the omission of such a provision will promote the national defense or be in the public interest; shall provide for the payment (in cash or in kind) by the lessee of consideration in an amount that is not less than the FMV of the lease interest, as determined by the secretary;¹² and shall provide that if and to the extent that the leased property is later made taxable by state or local governments under an act of Congress, the lease shall be renegotiated.

Concerning lease consideration, section 2667 provides that if the consideration is to be cash, then the cash payments must be deposited into a special account in the U.S. Treasury and may only be used in such

¹⁰See footnote 1.

¹¹The description of section 2667 provisions is not intended to be exhaustive, but rather includes provisions discussed in this report.

¹²However, if a lease is for property located at a military installation approved for closure or realignment under a base closure law and the final disposition of that property is pending, the secretary concerned may accept consideration in an amount less than FMV, if the secretary determines that a public interest will be served as a result of the lease and the FMV is either unobtainable or not compatible with the public benefit. 10 U.S.C. § 2667(g)(2).

amounts as provided in appropriations acts.¹³ Also, once these amounts are appropriated, section 2667 provides that the installation where the leased property is located receive at least 50 percent of that consideration and that the appropriated cash may be used for specific enumerated purposes relating to real property construction, maintenance services, lease of facilities, or payment of utility services. In the event that consideration for the lease is to be in kind, then section 2667 provides a nonexhaustive set of examples of acceptable forms of in-kind consideration that includes the maintenance, protection, alteration, repair, improvement, or restoration of property or facilities; the construction of new facilities; and the provision of facilities, utility services, or real property maintenance services.

The military services have long used the authority under section 2667 to enter into short-term leases of military property for such uses as farming, grazing, and cellular towers, and in turn received cash consideration. According to the services, they had about 3,000 such leases, which generated about \$20.8 million in cash consideration in fiscal year 2010. The services have also used the authority contained in section 2667 to enter into more complex leases that the services refer to as EULs. Although the authorizing statute, section 2667, does not use “enhanced use lease” to differentiate leases executed pursuant to this authority, the services generally distinguish an EUL from a normal outlease on the basis of scope, process, term, and consideration. For example, according to the services, EULs generally involve larger amounts of property, generally undergo a more detailed evaluation and review before approval and greater oversight after approval, often are executed for longer periods of time (such as 25 to 50 years), and generally focus on in-kind, rather than cash, consideration. Each service has issued policy guidance for implementing EULs using the authority provided by section 2667.

EUL Program Management

In general, EUL program management includes those activities involved with the identification, evaluation, and justification of potential EULs; the

¹³The statute provides a few specific exceptions to this rule. For example, money rentals received for agricultural or grazing purposes may be retained and spent by the secretary concerned in such amounts as the secretary considers necessary to cover the administrative expenses of leasing the land and to cover the financing of multiple-land use management programs, and there are special rules and exceptions for money rentals received at a military installation approved for closure or realignment under a base closure law. 10 U.S.C. § 2667(e)(3), (4), and (5).

solicitation and selection of the EUL developer; lease negotiation; and lease administration to include oversight of in-kind services. The Office of the Secretary of Defense has overall responsibility and oversight of DOD real property and establishes overarching guidance and procedures for the management of DOD real property. However, because section 2667 provides authority to the military service secretaries to lease real or personal property, subject to the provisions contained in the section, the military departments have direct responsibility for implementing leases under section 2667. In the Army, the authority to execute EULs was delegated to the Deputy Assistant Secretary of the Army (Installations and Housing), and certain responsibilities for executing the Army EUL program have been further delegated to the U.S. Army Corps of Engineers. In the Navy, the authority to establish and supervise execution of Navy policies and procedures relating to the use of real property and real estate contracting actions (including EULs) has been delegated to the Deputy Assistant Secretary of the Navy (Energy, Installations, and Environment), and real estate contracting authority for the Navy EUL program has been delegated to the Naval Facilities Engineering Command. In the Air Force, overall responsibility for the execution of initial EUL transaction documents and leases has been delegated to the Assistant Secretary of the Air Force (Installations, Environment and Logistics), and responsibility for executing additional leases pursuant to section 2667 has been delegated to the Air Force Real Property Agency.

Services’ EUL Program

At the end of fiscal year 2010, the Army, the Navy, and the Air Force reported that a total of 17 EULs were in place and that 37 additional EULs were in various phases of review or negotiation for possible future implementation. Table 1 breaks down this information by service, and appendix II identifies and provides details on each of the 17 EULs.

Table 1: Military Services’ EULs as of September 30, 2010

Service	In place	Under consideration
Army	7	14
Navy	5	10
Air Force	5	13
Total	17	37

Sources: Army, Navy, and Air Force.

As shown in table 1, the Army reported 7 EULs in place¹⁴ and 14 EULs under consideration¹⁵ at the end of fiscal year 2010. Many of the Army's EULs were long-term leases that called for the development of leased land, which would be rented to private sector entities for profit. Army officials stated that many of the leases provided for the Army to receive a share of the net rental income as compensation in the form of in-kind services for the maintenance or improvement of installation facilities. The three Army EULs in our case studies, which were composed of several different leases and other legal documents, follow:

- Fort Sam Houston EUL.¹⁶ In June 2001, the Army entered into three 50-year lease agreements at Fort Sam Houston, Texas.¹⁷ According to the Army, the overall purpose of the EUL was to lease three large, deteriorated, vacant buildings situated on the installation to a private developer who would renovate the buildings as office space and then sublease the space to private sector tenants for profit. As consideration, the Army was to receive a share of the development's net rental income. Such revenue was to be deposited into an escrow account in order to fund future work projects on installation facilities.¹⁸ Army officials stated that the EUL also benefited the Army by eliminating Army costs associated with maintaining the old buildings.

¹⁴The Army reported that it previously had two additional EULs. First, the Army reported that an EUL at Fort Bliss, Texas, was signed in 2006 and terminated by the Army in 2010 because the lessee had made no progress in developing the property and the lease included a provision that allowed the Army to terminate the lease for this reason. Second, the Army reported that an EUL at Walter Reed Army Medical Center, Washington, D.C., was signed in 2004. However, the center is closing as part of the 2005 BRAC process, and the Army expected that the lease would be transferred to the new property owner.

¹⁵See footnote 6.

¹⁶On October 1, 2010, as a result of the 2005 Defense Base Closure and Realignment Commission recommendation that DOD establish 12 joint bases by consolidating the management and support of 26 separate installations, Fort Sam Houston, Lackland Air Force Base, and Randolph Air Force Base became Joint Base San Antonio. With the implementation of this joint basing action, the Air Force became responsible for installation support at the joint base, including the administration of the Fort Sam Houston EUL.

¹⁷A fourth site lease was executed in September 2007. Further, the terms of some of the Fort Sam Houston leases were later amended to 55 years.

¹⁸An escrow agreement is employed in three of the four Fort Sam Houston leases. Army officials explained that no escrow agreement was in place for one of the four Fort Sam Houston EULs because work had not begun pursuant to that site lease, and therefore no revenue was being generated under that site lease.

-
- **Picatinny Arsenal EUL.** In September 2006, the Army entered into a master agreement with a private developer at Picatinny Arsenal, New Jersey. The master agreement does not lease any property¹⁹ but instead is an agreement to later enter into separate leases with the lessee to incrementally develop 13 different parcels of property, which consists of 100,000 square feet of existing facility space in four buildings and about 120 acres of land.²⁰ The master agreement makes the majority of the parcels available for lease at the lessee's sole discretion, in any order and at any time of the lessee's choosing.²¹ The Army's expectation was that the developer would renovate or replace the existing buildings and build and rent laboratory, administrative, educational, and light manufacturing space as part of a research campus on up to 120 acres, which would in turn be leased to private sector tenants for profit. As consideration, the Army would receive certain up-front payments upon the execution of leases for the various parcels, and would also receive a share of the net rental income generated by the developed property. Both the up-front payments and the revenue share were to be deposited into an escrow account, from which funds could be disbursed as cash or to pay for in-kind projects at the installation. At the time of our review, the Army had entered into two separate site lease agreements with the lessee with 50-year terms—one concurrently with the master agreement and the other in August 2007.
 - **Aberdeen Proving Ground EUL.** In September 2006, the Army entered into a master agreement at Aberdeen Proving Ground, Maryland. The master agreement does not lease any property²² but instead is an agreement to later enter into separate leases with the lessee to incrementally develop 416 acres of Army land. In turn, the lessee was expected to construct

¹⁹The master agreement does, however, grant the lessee certain rights of entry for prelease activities and access and infrastructure improvements.

²⁰The term of the master agreement is not explicitly specified. It is the Army's position that the master agreement remains in effect as long as any associated parcel lease remains in effect.

²¹The lessee is not specifically required to enter into site leases for all of the land subject to the master agreement. Aside from the special rules for two buildings, the only conditions under which the Army may refuse to enter into a site lease with the lessee that would not be considered an event of default would be if the prospective use of the property constituted a prohibited use or was not consistent with the uses authorized under the master agreement.

²²The master agreement does, however, give the developer the right to construct infrastructure improvements necessary to support and service construction for a prospective site lease.

buildings for an office and technology park.²³ As consideration, the EUL called for the lessee to pay the Army rent on completed buildings and the rent would be deposited into an escrow account, from which funds would be disbursed as cash or to pay for in-kind projects at the installation. At the time of our review, the Army had entered into eight separate site lease agreements with 50-year terms.

Table 1 also shows that the Navy reported 5 EULs in place and 10 EULs under consideration at the end of fiscal year 2010. Most of the Navy's EULs involved leases of Navy property that the lessee used without further development, such as the leasing of Navy-owned land to a private company for off-loading and storing automobiles. According to the Navy, the leases typically provided for the Navy to receive rent as consideration for the leased property in the form of in-kind services for the maintenance or improvement of installation facilities. The Navy EULs in our case studies did not provide for consideration to be deposited in an escrow account, from which funds could be disbursed to pay for in-kind services. Rather, upon satisfactory completion of in-kind services, the rental payment value due would be credited by an amount equal to the cost of the in-kind services. The three Navy EULs in our case studies follow:

- **Naval Base Point Loma EUL.** In October 2005, the Navy entered into a 5-year lease agreement at Naval Base Point Loma, California. According to the Navy, the overall purpose of the EUL was to lease about 432,000 square feet of industrial and storage space in a Navy-owned building to a private sector company, which planned to use the property to assemble rocket propulsion fuel tanks in fulfillment of military contracts.²⁴ The EUL required the lessee to pay rent to the Navy in five consecutive, annual payments; but at the option and sole discretion of the Navy, the annual rental payment could be offset by the costs of accomplishing in-kind services.²⁵ Upon satisfactory completion of in-kind services, the annual rental payment due would be credited by an amount equal to the cost of the services. Thus far, all of the consideration the Navy has received under this EUL has been in the form of in-kind services, such as performing roof repairs and modernizing restrooms at the leased building.

²³While the master agreement does not set out a detailed, binding schedule for entering into site leases or for developing the property, it does contain deadlines for the developer's progress. For example, the developer must have entered into site leases with regard to the entire project site by June 2029.

²⁴The lease term was extended on January 5, 2011, for a term of 3 months effective February 1, 2011.

²⁵The EUL calls in-kind services "specific maintenance projects."

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- Naval Base Ventura County EUL. In March 2007, the Navy entered into a 5-year lease agreement at Naval Base Ventura County, California. According to the Navy, the overall purpose of the EUL was to lease over 100 acres of Navy land to a private sector company, which planned to use the property to off-load and store automobiles. As consideration, the Navy would receive annual rent; but at the sole option of the Navy, the annual rent could be offset by the cost of accomplishing in-kind services. Thus far, all of the consideration the Navy has received under this EUL has been in the form of in-kind services, such as performing road and pavement repairs at the installation.
 - Naval Base San Diego EUL. In August 2008, the Navy entered into a 30-year lease agreement at Naval Base San Diego, California. According to the Navy, the overall purpose of the EUL was to lease about 4.8 acres of Navy land and one Navy-owned building situated on the land to a private sector company, which planned to use the property to assist in the construction of ships under a contract with the Navy. As consideration, the EUL provided for rental payments, but in lieu of cash payments, the lessee would provide in-kind consideration in the form of maintenance, repair, improvement, and construction of new facilities. Specifically, the EUL required the lessee to perform the in-kind services at its own expense, and in exchange, the Navy would provide a rent credit for the actual cost incurred against the annual rent. Thus far, all of the consideration the Navy has received under this EUL has been in the form of in-kind services.

Table 1 further shows that the Air Force reported 5 EULs in place and 13 EULs under consideration at the end of fiscal year 2010.²⁶ Air Force officials stated that Air Force EULs generally were long-term leases that included various arrangements from relatively straightforward leases of land in exchange for rent payments as consideration to one more complex lease that called for the development of leased land, which would be rented to private sector tenants with the Air Force receiving a consideration payment when the EUL was signed and also receiving a share of the development's net rental income as compensation. According to Air Force officials, the Air Force EULs generally called for consideration to be received in the form of in-kind services for the maintenance or improvement of installation facilities. The three Air Force EULs in our case studies follow:

- Eglin Air Force Base. In October 2006, the Air Force entered into a 30-year lease agreement at Eglin Air Force Base, Florida. According to the Air

²⁶In December 2010, the Air Force terminated one of its EULs because of lessee default.

Force, the overall purpose of the EUL was to lease 255.5 acres of land to a Florida county government, which planned to use the property to construct a new wastewater treatment plant and disposal system. As consideration, the Air Force would receive rent to be deposited into an escrow account and disbursed as cash or to pay for in-kind projects performed on installation facilities.

- Eglin Air Force Base. In July 2007, the Air Force entered into a 25-year lease agreement at Eglin Air Force Base, Florida. According to the Air Force, the overall purpose of the EUL was to lease 130.8 acres of land to a Florida county government, which planned to use the property to operate and maintain an existing airport terminal and rental car services. As consideration, the Air Force would receive rent to be deposited into an escrow account and disbursed as cash or to pay for in-kind projects performed on installation facilities.
- Hill Air Force Base. In August 2008, the Air Force entered into a master development agreement with a private developer at Hill Air Force Base, Utah. The master development agreement does not lease any property. Instead, the agreement explains that the EUL site consists of 499 acres²⁷ that will be outleased incrementally through individual site leases and sets forth the general terms, conditions, and rights under which the Air Force and the developer may later execute these site leases. The developer was expected to construct commercial facilities for rent to private sector tenants for profit. As consideration for the EUL, the Air Force received an up-front payment from the developer when the master development agreement was signed.²⁸ The Air Force also expects to receive a share of the development's net rental revenues from developed property, which is to be placed in a special account outside the U.S. Treasury and used to fund in-kind services at the installation.²⁹ Additionally, grants from the State of Utah were anticipated to be disbursed to the developer for

²⁷The Air Force planned to add approximately 51 acres to this lease at a later date.

²⁸The Air Force stated that a portion of the up-front consideration received from the developer was accepted pursuant to section 2695 of Title 10, U.S. Code, which permits the secretary of a military department to accept amounts provided by a person or entity to cover administrative expenses incurred by the secretary in entering into the transaction.

²⁹These funds are to be deposited into a "payment in-kind account." The Air Force, the developer, and the Military Installation Development Authority, an independent, nonprofit entity of the State of Utah, entered into an agreement related to the receipt, administration, accounting, and dispensation of funds in the payment in-kind account. Among the authority's obligations under this agreement is the responsibility to act as the "owner" of the payment in-kind account and act as trustee of the account with a fiduciary duty to the government to ensure that funds will be distributed and will only be distributed if the conditions for distribution set forth in the agreement are met. The Air Force has a security interest in the payment in-kind account.

acceptable state purposes—such highway improvements and infrastructure development—that may facilitate and benefit the Hill Air Force Base EUL. At the same time that the Air Force entered into the master development agreement, the Air Force also entered into a master lease, which grants to the developer certain limited property rights for a 50-year term, including entry, planning and constructing certain utility systems and infrastructure necessary to support development of the anticipated site leases. At the time of our review, the Air Force had entered into one 50-year site lease.³⁰

Certain Army and Air Force EULs Did Not Comply with Some Statutory Requirements

One of the Army EULs included in our case studies did not comply with some requirements contained in the EUL authorizing statute, section 2667 of Title 10. On March 30, 2011, GAO issued a legal opinion finding that certain terms and conditions of the legal documents comprising the Army's Picatinny Arsenal EUL violated subsection 2667(e), which requires that cash consideration be deposited into the U.S. Treasury, and certain other statutes (see app. III). Also, while no two EULs are identical, we found that the other five Army and Air Force case study EULs included some terms and conditions similar to those that were found to be problematic by the legal opinion, which raises questions about the extent to which such EULs comply with the statutory requirements. In addition, beyond those issues addressed in the legal opinion, we found that the three Army case study EULs and one Air Force case study EUL did not fully comply with another provision in section 2667 that requires that each lease executed pursuant to section 2667 provide for lease renegotiation if taxes are imposed on leased property. We did not find similar legal issues in the three Navy EUL case studies. Unless the Army and the Air Force review their EULs and take steps, if needed, to ensure compliance with applicable statutes, then uncertainty will continue to exist as to whether the services' EULs meet all statutory requirements.

Legal Opinion Addressed Certain Compliance Issues

On March 30, 2011, we issued a legal opinion in which we concluded that certain terms and conditions of the legal documents comprising the Army's Picatinny Arsenal EUL failed to comply with subsection 2667(e) of Title 10 and the miscellaneous receipts statute by failing to require that cash consideration be deposited into the appropriate account of the U.S.

³⁰This lease was entered into on March 27, 2009, for approximately 7.7 acres of land.

Treasury.³¹ Further, the opinion found that the Picatinny Arsenal EUL violated the Antideficiency Act by including a clause in the escrow agreement whereby the government indemnified the escrow account agent against all liabilities arising under the escrow agreement. A summary of the legal opinion follows:

- First, the opinion concluded that certain terms and conditions of the Picatinny Arsenal EUL did not comply with section 2667. Section 2667 specifies that consideration for a lease executed under this authority must come in one of two forms—cash payments or in-kind consideration—and subsection 2667(e) requires that cash payments be deposited into a special account in the U.S. Treasury and are available to the Secretary concerned only to the extent provided in appropriations acts. However, the applicable legal documents comprising the Picatinny Arsenal EUL provided that rent consideration from the lessee be deposited into an escrow account—specifically, deposited into an individual interest-bearing account at a local credit union. The legal documents further provide that such escrowed funds may be disbursed either to a third-party contractor as payment for services rendered or directly as a cash payment to the Army. At the time of our visit to Picatinny Arsenal in July 2010, about \$1.5 million of escrowed funds had been disbursed to pay third-party contractors for construction, repairs or similar work performed on property under the control of the Secretary. The opinion found that the terms and conditions of the legal documents comprising the Picatinny Arsenal EUL indicated that the Army had control over the disposition of the escrow funds which, except for the payment of expenses of the escrow agent, are used solely for the benefit of the Army. Therefore, the opinion concluded that the Picatinny Arsenal EUL violated section 2667 by effectively receiving cash, not in-kind, consideration, and depositing such proceeds into an escrow account instead of the special account in the U.S. Treasury for such purposes as required by subsection 2667(e).

³¹The Comptroller General issues legal decisions to agency officials on questions involving the use of, and accountability for, public funds. A decision regarding an account of the government is binding on the executive branch and on the Comptroller General, but is not binding on a private party who, if dissatisfied, retains whatever recourse to the courts he or she would otherwise have had. The Comptroller General has no power to enforce decisions. Ultimately, agency officials who act contrary to Comptroller General decisions may have to respond to congressional appropriations and program oversight committees. GAO also prepares legal opinions, such as our March 30, 2011, legal opinion referenced here, at the request of congressional committees or individual members of Congress on questions involving the use of, and accountability for, public funds. Such opinions are prepared in letter, rather than decision, format but have the same weight and effect as decisions. The March 30, 2011 legal opinion supplements our audit report and is reprinted in app. III.

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- Second, the opinion concluded that certain terms and conditions of the Picatinny Arsenal EUL did not comply with the miscellaneous receipts statute. The miscellaneous receipts statute provides that an official or agent of the government receiving money for the government from any source shall deposit the money in the U.S. Treasury as soon as practicable without deduction for any charge or claim.³² However, as discussed above, the applicable legal documents comprising the Picatinny Arsenal EUL provided that rent consideration from the lessee be deposited into an escrow account at a local credit union. The opinion found that the escrowed funds constituted “money for the government” and that the Army’s failure to immediately deposit the consideration received for the Picatinny Arsenal EUL into the appropriate account in the U.S. Treasury was a violation of the miscellaneous receipts statute.
 - Third, the opinion concluded that an indemnification provision in the escrow agreement for the Picatinny Arsenal EUL, whereby the government agreed to indemnify the escrow agent against all liabilities, violated the Antideficiency Act. The Antideficiency Act prohibits agencies from spending, or committing themselves to spending, in advance of or in excess of appropriations, unless specifically authorized by law.³³ Once it has been determined that there has been a violation of the Antideficiency Act, the agency head must report immediately to the President and Congress all relevant facts and provide a statement of actions taken, and must also transmit a copy of each report to the Comptroller General.³⁴ The opinion concluded that the open-ended indemnification provision constituted a violation of the Antideficiency Act. Further, the opinion noted that although the Army subsequently cured the violation by amending the escrow agreement to delete the indemnification provision,³⁵ a report of the violation is still required.

The legal opinion recommended three actions. First, with respect to the section 2667 and miscellaneous receipts violation, the opinion

³²31 U.S.C. § 3302(b).

³³31 U.S.C. § 1341.

³⁴31 U.S.C. § 1351.

³⁵While not discussed in our legal opinion, we understand that the indemnification provision was removed in response to an April 24, 2009 memorandum by the Chief Counsel for U.S. Army Corps of Engineers. The memorandum stated that a similar indemnification provision included in an Army EUL not included in our case study review violated the Antideficiency Act. The memorandum advised the preparation of a “flash report,” and concluded that all existing and pending Army EULs should be reviewed and, if necessary, renegotiated.

recommended that the Army transfer the balance of the escrow funds to the appropriate account in the Treasury, and with respect to the escrow funds that have been expended to date, the Army adjust its accounts by transferring funds from an Army account available to pay for services to property under the control of the Secretary to the appropriate account in the Treasury. Further, the opinion noted that if the Army finds it lacks sufficient budget authority to adjust its accounts, it should report a violation of the Antideficiency Act. Second, with respect to the indemnification provision in the original escrow agreement, the opinion encouraged the Army to make the necessary report as soon as possible. Third, the opinion stated that to the extent that the Army has entered into EULs on substantially similar terms and conditions as the Picatinny Arsenal EUL, the Army should take the same corrective action.

Provisions Similar to Those Addressed in the Legal Opinion Existed in Other EULs

While no two EULs are identical, we found that the five other Army and Air Force EULs in our case study review required that some or all cash consideration received pursuant to the EUL be deposited into an escrow account and not the U.S. Treasury before being disbursed from the escrow account to pay for in-kind construction and maintenance projects, which raises questions about the extent to which such EULs comply with section 2667 and the miscellaneous receipts statute.³⁶ For example, the Aberdeen Proving Ground EUL, the Fort Sam Houston EUL, the Hill Air Force Base EUL, and the two Eglin Air Force Base EULs provide for some or all consideration received pursuant to the EUL to be first deposited into an escrow, or similar, account and not the U.S. Treasury.³⁷ In addition,

³⁶Depositing EUL cash consideration into an escrow account rather than the U.S. Treasury also raises questions about the disbursement and use of such funds from those accounts. For example, under the Fort Sam Houston EUL, to the extent that the deposit of consideration into an escrow account instead of the U.S. Treasury represented a violation of section 2667, payments out of that account would also be problematic—such as the disbursement of \$223,000 that was made to the U.S. Army Corps of Engineers to pay for EUL program administrative costs.

³⁷Some of these EULs provide for a portion of the consideration received to be provided directly as payment for administrative costs pursuant to section 2695 of Title 10, U.S. Code, which permits the secretary of a military department to accept amounts provided by a person or entity to cover administrative expenses incurred by the secretary in entering into the transaction. For example, in the Hill Air Force Base EUL, while some consideration was accepted directly by the government pursuant to section 2695, the master development agreement requires the developer to deposit additional up-front consideration and a percentage of the net operating revenues into a payment in-kind account outside the U.S. Treasury. For the purposes of this discussion, we refer only to the EUL provisions that provide for the payment of some or all consideration received pursuant to the EUL into an escrow, or similar, account outside of the U.S. Treasury.

although not included in our EUL case studies, the escrow agreements executed by the Army in connection with the EUL at Yuma Proving Ground, Arizona, and the EUL at Fort Detrick, Maryland, contained indemnification provisions similar to the indemnification provision in the Picatinny Arsenal EUL that was discussed in our legal opinion. The Army took similar action with respect to these indemnification provisions as it did with the Picatinny Arsenal EUL provision by amending the escrow agreements to delete the indemnification provision.³⁸ Thus, the indemnification provisions that were present in the Yuma Proving Ground EUL and the Fort Detrick EUL raise questions about the extent to which such EULs complied with the Antideficiency Act and the associated reporting requirements.

Additional Compliance Issues Existed in Some EULs

Beyond those issues addressed in the legal opinion, we found that the legal documents executed in several Army and Air Force EULs in our case study review failed to include a provision providing that if and to the extent that the leased property is later made taxable by state or local governments under an act of Congress, the lease shall be renegotiated.³⁹ Specifically, all of the Army EULs in our case study and one of the Air Force EULs in our case study executed pursuant to section 2667 contained at least one lease that either failed to address what would happen should the leased property be later made taxable by state or local governments under an act of Congress or otherwise did not provide for lease renegotiation in accordance with section 2667. For example, the Eglin Air Force Base Wastewater EUL contained no provision addressing what would happen should the leased property later become taxable. In the Fort Sam Houston EUL, each of the four leases requires the lessee to pay any and all taxes imposed, while the two site leases executed as part of the Picatinny Arsenal EUL and two of the eight site leases executed as part of the Aberdeen Proving Ground EUL require the lessee to pay taxes imposed by the state and permit the lessee to reduce the amount of rent payable to the Army by the amount of any taxes on the leased property. By failing to include the required tax provision, these legal documents were not in compliance with the section 2667 requirement.

³⁸As in the case of the Picatinny Arsenal EUL, we understand that the indemnification provision was removed in response to an April 24, 2009, memorandum from the Chief Counsel for the U.S. Army Corps of Engineers.

³⁹10 U.S.C. § 2667(f).

Army and Air Force Expectations for Some EULs Were Not Realized

The services' expectations for EUL development time frames and financial benefits were not realized in two Army EULs and one Air Force EUL included in our case studies, and some received markedly less consideration to date than initially estimated. Service expectations for the remaining two Air Force and three Navy EUL case studies were generally realized, and for the remaining Army EUL case study, we could not clearly determine whether development time frame expectations were realized because the Army did not prepare detailed development plans that established clear time frame expectations for the project.⁴⁰ According to the services, the recent economic downturn caused development plans for several EULs to significantly slow down or to be placed on hold. As a result, buildings were not constructed or renovated as planned and were not rented to private sector tenants as planned. Thus, projected rental revenues and the services' expected share of these revenues did not materialize.

Army and Air Force Expectations for EUL Development Time Frames and Financial Benefits Were Not Realized in Some Cases

We found that expected development time frames and financial benefits were not realized in two of the Army and one of the Air Force EULs we reviewed. For example, when the first site leases for the Fort Sam Houston EUL were signed in 2001, the Army expected that the developer would renovate the three large, deteriorated buildings included in the lease for use as office space and then sublease the space to private sector tenants for profit. Initially, the Army expected that it would receive about \$253 million in in-kind consideration over the 50-year lease term from its share of the project's net rental revenue. However, the project has not been developed as expected. Specifically, the lessee has renovated only two of the three deteriorated buildings,⁴¹ and according to Army officials, nearly all of the EUL office space is rented to the Army rather than to private sector tenants. This occurred for two reasons. First, after the terrorist attacks of September 11, 2001, access to the installation became

⁴⁰In the Aberdeen Proving Ground EUL, the master agreement provided broad deadlines for development—for example, the developer must enter into site leases with regard to the entire project and must have commenced construction of improvements on the leased premises before June 30, 2029. While neither the master agreement nor other Army documents provided detailed development time frame expectations, the installation's EUL project manager stated that initial time frame expectations slipped 6 to 12 months when the original EUL developer filed for bankruptcy and a different developer took over the project.

⁴¹Although not anticipated when the original leases were signed in 2001, the developer constructed a new office building on Army land included in the EUL.

restricted, which increased the complexity of renting space to private sector tenants. Second, the Army made several decisions after the lease was signed to relocate Army organizations to Fort Sam Houston, which resulted in a significant increase in the need for Army office space at the installation. Even if the Army had wanted to terminate one or all of the EUL leases because of these changes, none of the leases included a clause to permit the government to terminate the lease for convenience. At the time of our visit in August 2010, the Army estimated that EUL consideration over 50 years would total about \$198 million, or about 22 percent less than was originally expected. Moreover, rather than resulting from the Army's share of rental revenues from private sector tenants, Army officials stated that nearly all of the estimated future consideration is now expected to be the result of the Army getting back a portion of the rent that the Army pays to the developer for using EUL office space. Figure 1 contains photographs of property included in the Fort Sam Houston EUL, including views of one of the renovated buildings, the building that has not been renovated, and a newly constructed office building on leased land.

Figure 1: Photographs of the EUL Project at Fort Sam Houston, Texas



Source: GAO.

Note: The photograph at the top left of the graphic shows the front view of a renovated building; the photograph at the top right shows a rear view of same renovated building; the photograph at the bottom left shows an office building constructed by the developer on land included in the lease; and the photograph on the bottom right shows a deteriorated, vacant building included in the lease that has not been renovated.

The Picatinny Arsenal EUL is the second EUL where expectations were not realized. When the master agreement for the Picatinny Arsenal EUL was signed in 2006, the Army anticipated that by October 2007 the developer would have renovated or replaced the four Picatinny Arsenal buildings included in the lease plan to provide 100,000 square feet of new or renovated office space that would be rented to private sector tenants for profit. Also, by May 2008, the Army anticipated that the developer would have constructed and rented to private sector tenants about 150,000 square feet of office space on vacant land included in the lease plan. Further, the Army initially estimated that it would receive about \$500 million in total in-kind consideration over the term of the EUL, of which about \$7.4 million in in-kind consideration from developer payments and the Army's share of net rental revenues would have been received by the end of 2010. However, the project has not been developed

as expected and the expected financial benefits have not been realized. At the time of our visit in July 2010, about 27,500 square feet of office space, or about 89 percent less than the amount initially expected, had been developed and about 16,200 square feet of this space was rented to private sector tenants. Also, through the end of 2010, the Army had received \$1.7 million in consideration for the lease, or 77 percent less than the amount initially expected, and the entire amount was paid by the developer when the first site lease was signed in 2006. According to Army officials, the project has not met expectations because of the economic downturn and it is not clear how much additional consideration will be obtained over the remaining lease term. The leases do not include a provision requiring minimal consideration payments to the Army in the event that the property was not developed as expected, and none of the leases contain a termination for convenience clause in the event that the Army desired to terminate the lease before the end of the EUL term. Figure 2 shows photographs of buildings covered by the Picatinny Arsenal EUL.

Figure 2: Photographs of the EUL Project at Picatinny Arsenal, New Jersey



Source: U.S. Army Corps of Engineers.

Note: Photograph on left shows the newly constructed 27,500-square-foot office building and the photograph on the right shows a vacant leased building that has been internally gutted but not yet renovated.

The Hill Air Force Base EUL is the third EUL where expectations were not yet realized. When the Hill Air Force Base master agreement was signed in 2008, the Air Force estimated that in addition to \$10 million in developer paid consideration, the Air Force would receive about \$385 million in in-kind facility improvements as consideration from its share of the project's net rental revenue over the EUL term. The Air Force also anticipated that about \$75 million in public funds from tax increment financing proceeds and public grants from the State of Utah would be provided to help support infrastructure improvements near military installations. Further,

by the end of 2010, the Air Force estimated that the developer would have begun construction of at least seven commercial buildings and that four of these buildings would be completed, leased to private sector tenants, and generating net rental income from which the Air Force would be receiving a share as consideration. However, the project has not been developed as expected largely, according to Air Force officials, because of the economic slowdown. At the time of our visit in August 2010, construction had not begun on any commercial buildings,⁴² and the only lease consideration actually received by the Air Force was about \$2.5 million, which the developer paid when the master lease agreement was signed in 2008.⁴³ Also, of the projected \$75 million in public funding, the Air Force originally estimated that \$45 million would be available to benefit the project by the end of fiscal year 2010. However, at the end of fiscal year 2010, about \$10 million in state grants had been made toward military installation infrastructure improvements—\$35 million less than estimated—and of this amount, about \$800,000 had been used to pay for the design of two facilities at Hill Air Force Base. The balance of the state funds was held by a state-created military installation development authority. Installation officials stated that they remained optimistic that the project would eventually develop as envisioned.

Although not one of our case studies, the EUL at Kirtland Air Force Base, New Mexico, also illustrates missed expectations. When the Kirtland Air Force Base EUL was signed in 2005, the Air Force expected that the lessee would develop the 8.3 acre property by constructing and subleasing office, research, and education facilities. Over the 50-year lease, the Air Force estimated that it would receive about \$2.7 million in lease consideration from annual ground rent payments and additional rent payments as the planned facilities were completed. However, from the time the lease was signed in 2005 through December 2010, Air Force officials stated that the Air Force received no consideration for the lease—the lessee made no

⁴²Ground breaking on the first commercial building occurred in October 2010, after our visit to Hill Air Force Base.

⁴³Although the EUL documents at Hill Air Force Base stated that the developer was making a \$10 million equity investment as consideration, \$2,548,068 was received by the Air Force when the lease was signed. This amount was used to pay EUL administrative costs. According to lease documents, the balance of the \$10 million was held by the developer, was to accrue interest at the rate that the developer could borrow funds from a commercial lender, and was to be deposited into the EUL's payment in-kind account "as needed" over the lease term. At the time of our visit in August 2010, no amounts from the balance had been deposited in the payment in-kind account.

ground rent payments to the Air Force and no facilities were constructed to generate additional rent. In December 2010, the Air Force terminated the lease because of lessee default.

The Services' Management of the EUL Program Includes Weaknesses in Internal Controls and Guidance

Our review of the services' management of the EUL program identified several weaknesses related to internal controls and program guidance. First, because the services generally lacked methodologies, analyses, or other documentation showing how certain provisions contained in the authorizing statute, section 2667 of Title 10, were addressed, it is not clear to what extent the services systematically considered and assessed each provision before entering into the leases. Second, while the statute leaves the determination of FMV to secretarial discretion and thus a particular methodology for determining FMV is not required, we found cases where it is not clear how and to what extent the services provided for the receipt of consideration in an amount that is not less than the FMV of the lease interest. Third, some EULs included property that was being used by the military or might be needed for military purposes over the lease term, which could result in increased costs to relocate military activities or increased potential government costs in the event a service had to terminate a lease to regain use of the property. Fourth, the services have not regularly monitored EUL program administration costs to help ensure that the costs are in line with program benefits.

The Services Lack Documentation That Certain Statutory Requirements Were Met

In the nine EUL case studies we reviewed, we found that the services generally lacked methodologies, analyses, or other documentation showing that certain provisions contained in section 2667 were addressed prior to entering into the leases. Among other things, section 2667 requires that each lease does not include excess property. This determination is particularly important given that some EULs include terms of 50 years or more and in view of recent emphasis on the disposal of excess or underused federal property as a cost savings measure. Other section 2667 provisions require that a lease may not be for a term in excess of 5 years, unless the secretary concerned determines that the lease will promote the national defense or be in the public interest, and that each lease permit the service to revoke the lease at any time, unless the secretary concerned determines that omission of such a provision will promote the national defense or be in the public interest. These determinations are left to secretarial discretion and supporting analyses or documentation evidencing the determinations is not specifically required by law. Nevertheless, internal control standards call for the documentation of management decisions and our review found that the services lacked

guidance on how to make the determinations and document them. Without such evidence, it is not clear to what extent the services systematically considered and assessed each requirement to ensure that each was met prior to entering into the leases.

In most cases, the services lacked supporting analyses or other specific documentation to show how the excess property determination was made. For example, five of the nine EULs in our case studies provided declarative statements in the lease documents that the property included in the lease was not excess property, and four EULs were silent on the matter. Similarly, concerning the secretarial determinations that leases exceeding 5 years would promote the national defense or be in the public interest, six of the seven EULs in our case studies with terms exceeding 5 years provided declarative statements that the leases promoted the national defense or were in the public interest, and the remaining EUL was silent on the issue. However, in most cases the services did not have analyses or documentation to support the determinations. Service officials explained that the declarative statements alone in some cases constituted the totality of the documentation of the secretary's determination.

Further, seven of the nine EULs in our case studies did not include terms permitting the government to revoke the lease at any time. According to some service officials, the primary reason for the omission is that at least for those EULs that call for property development, the lessee normally seeks commercial loans to aid in the development and commercial lenders would not lend money for a project that might be terminated before the lender was able to recover the loan. Thus, the services often omit from their EULs a clause permitting lease termination at the government's convenience. However, the statute requires a determination that the omission would promote the national defense or be in the public interest. We found that six of the seven EULs without the clause included a declarative statement that the omission would promote the national defense or be in the public interest and the remaining EUL was silent on the matter. Yet in all seven cases the services lacked analyses or documentation showing how the secretary determined that the omission would promote the national defense or be in the public interest.

Table 2 summarizes our analysis of the services' consideration of these three section 2667 provisions.

Table 2: Summary of the Services' Consideration of Three Section 2667 Provisions

EUL location	Excess property		If lease term exceeded 5 years		If government termination for convenience clause was omitted	
	Did lease state that the property was not excess? ^a	Did the service have documentation showing how this secretarial determination was made?	Did lease state that the longer term would promote the national defense or be in the public interest? ^b	Did the service have documentation showing how this secretarial determination was made?	Did lease state that the omission will promote the national defense or be in the public interest? ^c	Did the service have documentation showing how this secretarial determination was made?
Fort Sam Houston	No	No	No	No	No	No
Picatinny Arsenal	No	No	Yes	No	Yes	No
Aberdeen Proving Ground	No	Yes	Yes	No	Yes	No
Naval Base San Diego	Yes	No	Yes	No	Yes ^d	No ^d
Naval Base Point Loma	No	No	N/A ^e	N/A ^e	N/A ^e	N/A ^e
Naval Base Ventura County	Yes	No	N/A ^e	N/A ^e	N/A ^e	N/A ^e
Hill Air Force Base	Yes	Yes	Yes	No	Yes	No
Eglin Air Force Base (Waste-water)	Yes	No	Yes	No	Yes	No
Eglin Air Force Base (Airport)	Yes	No	Yes	No	Yes	No
Summary	5 Yes	2 Yes	6 Yes	7 No	6 Yes	7 No
	4 No	7 No	1 No	2 N/A	1 No	2 N/A
			2 N/A		2 N/A	

Source: GAO analysis of EUL documentation provided by the Army, Navy, and Air Force.

^aSection 2667 does not require that leases executed under this section state that the property is not excess.

^bSection 2667 does not require that leases executed under this section with a term longer than 5 years state that a longer term would promote the national defense or be in the public interest.

^cSection 2667 does not require that leases executed under this section that omit a provision permitting the government to terminate the lease at any time state that the omission will promote the national defense or be in the public interest.

^dWhile this EUL does not contain a clause permitting the Navy to terminate at any time, it does permit the Navy to terminate the lease in the event that the property is required for federal use, or if the lessee's use of the property is not consistent with federal program purposes.

^aNot applicable (N/A) because lease did not exceed 5 years or lease did not omit a government termination for convenience clause.

It Is Not Clear How and to What Extent the Army's and the Air Force's EULs Provided for the Receipt of Fair Market Value

How and to what extent the Army's and the Air Force's EULs provide for the receipt of the FMV of the leased property, as required by section 2667, is unclear. Section 2667 requires that each lease provide for the payment (in cash or in kind) by the lessee of consideration in an amount that is not less than the FMV of the lease interest, as determined by the service secretary. While the statute leaves the determination of FMV to secretarial discretion, and thus a particular methodology for determining FMV is not required, we found cases where receipt of FMV was questionable largely because service guidance for determining and ensuring the receipt of FMV for proposed EULs was not always clear. Specifically, as illustrated below, we found one Army case where receipt of FMV cannot be ensured because the FMV of leased property was not determined; two Air Force cases where the agreed-to amount of lease consideration was below at least one appraisal of the value of the leased property; and other cases where the receipt of FMV depended on the service receiving a share of the net rental revenues from a project's development, which could potentially result in FMV not being obtained in the future.

First, the Army did not appraise about 39 of the approximately 41 acres of land included in the Fort Sam Houston EUL. The three 2001 site leases comprising the Fort Sam Houston EUL initially included three primary old, deteriorated buildings and associated land that was used mostly for parking. According to the Army, about 36 acres of land was included in these original leases. To determine the FMV of the property, the Army used an appraisal that determined that the FMV of several buildings was \$1.00 per year because of their poor condition. However, in determining the FMV of the land, an appraisal was conducted for only 2 acres—not the 36 total acres included in the original leases. Also, Army officials stated that the Army and the lessee subsequently agreed in 2008 to add several acres of Fort Sam Houston land to the EUL in exchange for the lessee returning to the Army some land associated with two of the old buildings' parking lots. The Army wanted to build a lodging facility on the land that had been included in the original lease. Although Army officials stated that the exchange resulted in a net increase of the total amount of Army land included in the EUL by about 5 acres, the Army did not determine the FMV of the additional land, which the lessee subsequently used as the site for constructing a new office building. Without a determination of the FMV of the land included in the Fort Sam Houston EUL, the Army cannot ensure

that the FMV of this property will be obtained over the remaining term of the EUL.

Second, for two of the three Air Force EULs in our case studies, the Air Force had appraisals completed to help determine the value of the property that was to be leased. Ultimately, the Air Force relied upon negotiations with the lessee, rather than the appraisals, to determine the FMV of the property, and in both cases, the Air Force accepted a negotiated amount of consideration that was less than the appraised value of the property. According to the Air Force, although it uses property appraisals as a guide for determining FMV, a property's actual FMV is the price a willing buyer could reasonably expect to pay a willing seller in a competitive market to acquire the property. Yet, in at least these two EUL cases, the Air Force's negotiations did not take place in a competitive market because the Air Force only negotiated with one party to determine the amount of consideration accepted for the lease interest. To illustrate, the Air Force hired a company to review two appraisals with differing estimates of the value of the property included in one Eglin Air Force Base EUL, referred to as the Okaloosa County Regional Airport EUL, and to provide its perspective on the value of the property. The company estimated that the FMV of the property was \$1,274,000 annually. After negotiations with one party, the lessee, the Air Force agreed to accept \$318,000 annually as consideration.⁴⁴ Thus, the negotiated amount was \$956,000, or 75 percent, less per year than the appraised value of the property. As another example, at the request of the Air Force, the U.S. Army Corps of Engineers performed an appraisal on about 256 acres of land included in the other Eglin Air Force Base EUL, referred to as the Arbennie Pritchett Water Reclamation Facility EUL. The appraisal estimated that the FMV of the leased property was \$513,000 annually. After negotiations with one party, the lessee, the Air Force agreed to accept \$325,000 annually as consideration.⁴⁵ Thus, in this case, the negotiated amount was \$188,000, or 37 percent, less per year than the appraised value of the property. Such cases raise questions about the extent to which the EULs will provide for receipt of the FMV of the lease interest.

Third, we found that FMV, as determined by the secretary concerned, might not be obtained in some EULs because of the terms contained in the lease agreements. For example, providing for the receipt of FMV can be

⁴⁴Lease provides for 3 percent escalation in the rental amount each year.

⁴⁵Lease provides for 2 percent escalation in the rental amount each year.

problematic in EULs where, in accordance with lease terms, the receipt of FMV depends on the service receiving a share of the net rental revenues from a project's development rather than receiving agreed-to rent payments or sufficient up-front cash payments that match or exceed the FMV. In such cases, if project development does not occur as expected, then project rental revenues—and thus the service's share of the rental revenues—also would not materialize as expected and the FMV of the lease interest might not be obtained. To illustrate, in the Picatinny Arsenal case, the Army determined that the FMV of the property that had been leased to the developer at the time of our visit in July 2010 was \$1,850,000. The Army received \$1,700,000 from the lessee when the first site lease was signed. However, obtaining the balance of the FMV depends on the Army receiving a share of net rental revenues, and because the project has not been developed as expected, the Army had not received any share of net rental revenues at the time of our visit.

Some EULs Included Property That Was Being Used by the Military or Had Potential for Being Needed by the Military over the Lease Term

Because of the cost to relocate military activities or the increased potential financial liability to the government if a service had to terminate a lease to regain use of leased property, it would appear imprudent for economic reasons for the services to lease property needed for military purposes. Yet, as illustrated below, we found cases where the military was using property included in the EUL and cases where there appeared to be reasonable potential that property included in the EUL might be needed for military purposes over the lease term, particularly in cases where the leased property was located in the interior, rather than at the perimeter, of an installation. As a result, the government apparently will incur increased relocation costs in one case and in other cases increased potential for future costs in the event that the service has to terminate a lease to regain use of the property. In 2008, after many of the leases in our case studies were signed, the Congress added a provision to section 2667 requiring that property to be leased must not for the time be needed for public use. However, we found that the services lacked guidance on the analyses and documentation needed to show that property to be leased is not needed for public use. Without such documentation, it will not be clear that the new provision will be met prior to entering into future leases.

For example, the master development agreement and master lease for the Hill Air Force Base EUL included property being used by the Defense Non-Tactical Generator and Rail Equipment Center, a DOD depot-level maintenance activity. The master development agreement obligates the Air Force to maintain and deliver the project site “free of tenants.” As such, the Air Force told the center that it would not be renewing the permit that

allowed the center to operate on Air Force land and that the center would have to relocate. However, according to the Army, which manages the center, funds were not available to pay for the relocation, which was estimated to cost from about \$37 million to \$45 million. Because the legal agreements that the Air Force signed obligate the Air Force to maintain and deliver the project site “free of tenants,” Air Force officials stated that if the center does not relocate, the lessee could sue the Air Force for \$41 million in damages.⁴⁶ The issue was not resolved at the time we completed our review. Figure 3 shows photographs of the Defense Non-Tactical Generator and Rail Equipment Center at Hill Air Force Base.

⁴⁶Given that the Air Force had not yet executed a site lease for the portion of the property encompassing the Defense Non-Tactical Generator and Rail Equipment Center, we asked the Air Force whether the 2008 amendment to section 2667 requiring that the property to be leased must not be needed for public use would prohibit the Air Force from entering into such a site lease. The Air Force acknowledged that the new amendment presents “interpretation issues” for the Air Force and stated that it is the Air Force’s legal position that site leases will have to comply with the provisions in the enabling statute at the time that the site lease is actually executed, unless that causes the Air Force to default on or breach the underlying master development agreement or master lease. Thus, the Air Force stated that the 2008 amendment to section 2667 does not prohibit the Air Force from including in a site lease a portion of the master project site that encompasses the Defense Non-Tactical Generator and Rail Equipment Center. In light of its legal position, it is unclear at this point how the Air Force intends to proceed with respect to the Hill Air Force Base EUL.

Figure 3: The Exterior and Interior of the Defense Non-Tactical Generator and Rail Equipment Center at Hill Air Force Base, Utah



Source: GAO.

As another example, when the first three site leases for the Fort Sam Houston EUL were signed in 2001, Army officials stated that the installation had no apparent need for the three large, deteriorated buildings and the associated land included in the lease. Still, given that the property was located in the interior of the installation surrounded by other Army buildings and activities, it would appear that there was a reasonable probability that the Army might have a need for the property over the 50-year lease term. As noted previously, shortly after the three original leases were signed in 2001, the Army relocated several Army organizations to Fort Sam Houston, which created a significant demand for office space. Because other office space on the installation was not readily available, Army officials stated that the Army leased back from the developer nearly all of the space in the EUL buildings that had been renovated. During our visit to Fort Sam Houston in August 2010, installation officials stated that the installation continued to have a need for office space and that the officials had considered terminating a portion of the EUL to regain control

of the one large building that the developer had not renovated so that the Army could renovate the building for its use. However, the officials stated that the Army most likely would not pursue this option because the lease did not include a termination for convenience clause, and therefore early termination could be very costly to the Army. Instead, installation officials stated that the Army was in the process of converting an old barracks building at the installation into office space for Army use. In another instance involving property included in the EUL, in 2008, the Army needed some of the land included in the EUL to build a new lodging facility. In this instance, Army officials stated that the Army was able to regain use of the needed property through a land exchange by amending the lease. However, Army officials stated that the exchange resulted in a net increase of about 5 acres in the total amount of Army land included in the EUL.

The Services Have Not Regularly Monitored EUL Program Administration Costs

We found that the services have not regularly monitored or performed periodic analyses of EUL program administration costs to help ensure that such costs are in line with program benefits. According to internal control standards for the federal government, activities need to be established to monitor performance measures and indicators, such as analyses of data relationships, so that appropriate actions can be taken, if needed.⁴⁷ Without regular monitoring and analysis, the services have less assurance that their EUL program administration costs are in line with program benefits.

While the services have no criteria for how much they should be spending on EUL program administration costs relative to program benefits, our analysis showed that EUL program administration costs ranged from 31 percent to 135 percent of the total EUL consideration received during fiscal years 2006 through 2010. Specifically, our analysis of information provided by the services concluded that EUL program administration costs, including personnel and consultant costs, equaled about 31 percent of the total EUL consideration received by the Army and the Navy and about 135 percent of the total EUL consideration received by the Air Force. As shown in table 3, the Air Force spent about \$10.4 million more to administer its EUL program than the amount of consideration received from its five EULs during fiscal years 2006 through 2010.

⁴⁷GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

Table 3: EUL Program Administration Costs and Consideration Received for Fiscal Years 2006 through 2010

Dollars in millions

Service	EUL program administration costs			Consideration received	Net benefit—consideration less costs	Costs as a percentage of consideration
	Personnel	Consultants	Total			
Army	\$4.2	\$2.0	\$6.1	\$20.0	\$13.9	31
Navy	4.7	8.9	\$13.5	44.1	30.6	31
Air Force	6.4	33.9	\$40.3	29.9	(10.4)	135
Total	\$15.3	\$44.7	\$60.0	\$94.0	\$34.0	64

Source: GAO analysis of data provided by the Army, Navy, and Air Force.

Notes: Our analysis of EUL program administration costs included the costs of service personnel and service consultants used to help administer the program each year. For the cost of service personnel, we first obtained information from each service on the number of full-time equivalent personnel used to help administer the EUL program each year for fiscal years 2006 through 2010. We then estimated the annual personnel costs by multiplying the numbers provided by services by the average cost per person, including benefits, according to annual DOD budget documents. For the costs of service consultants, we obtained and used the amounts that each service reported as the amounts paid for consultant support for the EUL program each year during fiscal years 2006 through 2010. Some totals in the table do not sum correctly because of rounding.

It is important to note that many of the EULs have long terms and consideration received in the future might significantly increase the net benefits from the program. In particular, Army and Air Force officials expressed expectations of greater EUL consideration in the future.

Conclusions

EULs offer the military services opportunities to reduce infrastructure costs by leasing nonexcess, underused military real property in exchange for cash or in-kind consideration that can be used to maintain or construct military facilities. However, the Army and the Air Force did not ensure that certain EULs were in compliance with some requirements contained in the EUL authorizing statute, section 2667 of Title 10, and similar compliance issues may exist in other EULs. Unless the Army and the Air Force review their EULs and take steps, as needed, to ensure that all EULs are in compliance with applicable statutes, then uncertainty will continue to exist as to whether the services' EULs meet all statutory requirements. However, an amendment to a lease must be negotiated and agreed to by the parties to the lease and thus may involve some costs. In addition, the services' management of the EUL program contains weaknesses related to internal controls and program guidance. First, unless the services issue guidance on how to determine and document that certain section 2667 provisions were addressed, it will not be clear how and to what extent the services systematically considered and assessed each provision to ensure

that each was met prior to entering into the leases. Second, without additional guidance on how the FMV of the lease interest should be determined and how the receipt of FMV can be best ensured, it will not be clear how and to what extent the services' EULs provide for the receipt of the FMV of the leased property. Third, section 2667 now requires that property to be leased must not be needed for public use during the lease term. However, unless guidance is issued on the analyses or documentation needed to ensure compliance with this requirement, future EULs could include property that might be needed for military purposes over the lease term, thus increasing potential government financial liabilities. Fourth, unless the services regularly monitor and analyze their EUL program administration costs, the services will have less assurance that program costs are in proportion with program benefits.

Recommendations for Executive Action

We are making six recommendations to address EUL statutory compliance issues and EUL program management concerns. Specifically, we are recommending that the Secretaries of the Army and the Air Force take the following three actions:

- Review all EULs for terms and conditions similar to those that our legal opinion concluded were inconsistent with applicable statutes; determine whether steps are needed to help ensure that the EULs are in compliance with applicable statutes; and, if so, then implement these steps.
- Take steps to ensure that all EULs provide that if and to the extent that the leased property is later made taxable by state or local governments under an act of Congress, the lease shall be renegotiated, as required by subsection 2667(f) of Title 10, U.S. Code.
- Review and clarify guidance describing how the FMV of the lease interest should be determined and how the receipt of FMV can be best ensured.

We also recommend that the Secretaries of the Army, the Navy, and the Air Force take the following three actions:

- Issue guidance on how to determine and document that section 2667 provisions were met prior to entering into an EUL, including the required secretarial determinations and the basis for the determinations.
- Issue guidance on the analyses or documentation needed to show that future leases executed under section 2667 do not include property needed for public use, as is now required by section 2667.
- Develop procedures to regularly monitor and analyze EUL program administration costs to help ensure that the costs are in line with program benefits.

Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD stated that it concurred with all of our recommendations and that the military services were taking appropriate measures to comply with the recommendations. However, DOD did not provide time frames for completing the planned actions to implement the recommendations. DOD's comments are reprinted in appendix IV.

DOD concurred with our recommendation to review all EULs for terms and conditions similar to those that our legal opinion concluded were inconsistent with applicable statutes; determine whether steps are needed to help ensure that the EULs are in compliance with applicable statutes; and, if so, then implement these steps. DOD stated that the Army and Air Force will review all their EULs executed to date and will amend lease terms and conditions as necessary in order to comply with applicable statutes. In addition, DOD proffered its view that the use of an escrow agreement as part of a EUL transaction represents a reasoned and permissible exercise of agency discretion to implement its statutory authority to collect in-kind consideration from a lessee through use of a commonly used legal instrument that provides substantial protection of U.S. financial interests. As the facts in the Picatinny Arsenal EUL demonstrated, the Army received a payment of cash and did not deposit it in the appropriate account in the U.S. Treasury as required by law. Instead, such consideration was deposited into an escrow account in satisfaction of the lessee's rent obligations, and the Army used these funds as if they were permissible in-kind consideration. Several provisions in the Picatinny Arsenal EUL and its associated legal documents indicated that the Army owned the funds in the escrow account. For example, the lessee was not obligated to provide any additional in-kind consideration beyond the funds deposited in the escrow account, escrow funds could only be used with the Army's consent, the lessee had no rights to the escrow funds, no in-kind deliverables were specified, and any interest earned in escrow was earned by the Army for income tax purposes. We would emphasize that simply calling a cash payment "in-kind services" does not make it so. As a consequence, the Army violated section 2667, violated the miscellaneous receipts statute, and augmented its appropriations. In its comments, DOD also stated that the department does not read either our report or our legal opinion as prohibiting the use of escrow agreements in connection with EUL transactions, provided the terms of those escrow agreements do not amount to constructive receipt of funds in the escrow agreement by the government. As we stated in our legal opinion, the opinion pertains primarily to the Picatinny Arsenal EUL and its associated legal documents. However, to the extent other EULs are on substantially similar terms as the Picatinny Arsenal EUL, our conclusions in the legal opinion apply to

those EULs as well, hence our recommendation, with which DOD concurred and said that it would implement.

DOD also concurred with our recommendation that the Army and the Air Force take steps to ensure that all EULs provide that if and to the extent that the leased property is later made taxable by state or local governments under an act of Congress, the lease shall be renegotiated, as required by subsection 2667(f) of Title 10, U.S. Code. DOD stated that the services will amend their existing EULs as needed and will incorporate the required provision in future EUL legal instruments.

In response to our recommendation that the Army and the Air Force review and clarify guidance describing how the FMV of the lease interest should be determined and how the receipt of FMV can best be ensured, DOD concurred. DOD stated that the Army and Air Force will revise their processes for establishing the FMV and prepare appropriate guidance, which will also establish procedures to verify that in-kind consideration received is not less than the FMV of the leasehold.

DOD also concurred with our recommendation that the Army, the Navy, and the Air Force issue guidance on how to determine and document that section 2667 provisions were met prior to entering into an EUL, including the required secretarial determinations and the basis for the determinations. DOD did not provide specific details for implementing the recommendation.

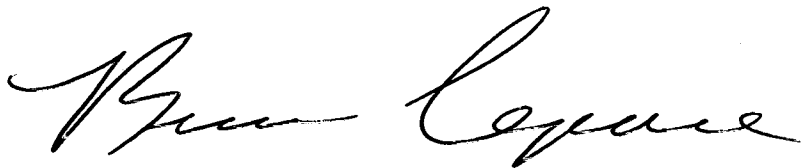
Concerning our recommendation that the services issue guidance on the analyses or documentation needed to show that future leases executed under section 2667 do not include property needed for public use, as is now required by section 2667, DOD concurred and stated that all three services will issue and update their EUL guidance on the analyses or documentation needed to establish that leases executed do not include property needed for public use. While concurring with the recommendation, DOD also stated that it disagreed with our use of the Fort Sam Houston EUL as an example of military property that was leased when there was a reasonable probability that the Army might have a need for the property in the future. DOD stated that the combination of circumstances that occurred after lease execution, including the terrorist attacks of September 11, 2001, and consequent effects on base access and Army space requirements, could not have been reasonably foreseen. We agree that the specific events that occurred after lease execution might not have been reasonably foreseen. However, our point is that the leased property was located in the interior of the installation surrounded by other

Army buildings and activities and that over the 50-year lease time frame, there was a reasonable probability that the Army might develop a need for the property, regardless of the specific events that might create a need. At a minimum, the Army could have anticipated that a requirement for the property or a portion of the property might arise and mitigated the potential consequences by including a termination for convenience clause or other appropriate provisions in the EUL.

Finally, DOD concurred with our recommendation that the services develop procedures to regularly monitor and analyze EUL program administration costs to help ensure that the costs are in line with program benefits. DOD stated that the Army will revise its EUL guidance to require standardization of EUL accounting and reporting of program costs and benefits and that the Air Force is developing methodology for baselining and tracking project and program administrative costs and rates of return to better enable the Air Force to forecast and monitor the effectiveness of the EUL program. DOD also stated that it expected administrative costs to decline in the future through the use of standardized documents and processes and that some EULs have benefits other than rental consideration that should be considered when comparing program costs and benefits.

We are sending copies of this report to the Secretary of Defense; the Secretaries of the Army, the Navy, and the Air Force; and the Commandant of the Marine Corps. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-4523 or leporeb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix V.

A handwritten signature in black ink, appearing to read "Brian Lepore", with a stylized, cursive script.

Brian J. Lepore
Director, Defense Capabilities and Management

List of Committees

The Honorable Carl Levin
Chairman
The Honorable John McCain
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Ranking Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable Howard P. McKeon
Chairman
The Honorable Adam Smith
Ranking Member
Committee on Armed Services
House of Representatives

The Honorable C.W. Bill Young
Chairman
The Honorable Norman D. Dicks
Ranking Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Appendix I: Scope and Methodology

To assess the extent to which enhanced use leases (EUL) selected for our case study complied with section 2667 of Title 10, U.S. Code, we reviewed the statute's legislative history; examined the statute's provisions; and obtained and assessed the military services' guidance, policies, instructions, and practices for ensuring compliance with the statute. We also interviewed officials from the Office of the Secretary of Defense, the Army, the Navy, and the Air Force to discuss the EUL program and service efforts to ensure that each EUL complies with the provisions contained in section 2667. While we reviewed information on all 17 EULs in place at the end of fiscal year 2010, to specifically assess EUL compliance with statutory requirements, we selected 9 of the 17 EULs for detailed case study review. The EULs were selected nonrandomly to include 3 from each service and a range of lease purposes, estimated financial benefits, and geographic locations.¹ We judgmentally selected these EULs because they represented each of the military services and were located in several different geographic locations. In each case study, we obtained, reviewed, and compared the lease agreements and related documentation with the statutory requirements in place at the time the respective agreements were signed, as well as applicable case law, to assess compliance. Also, at each installation visited, we discussed with installation officials the policies, procedures, and practices used for implementing the EULs and ensuring compliance with section 2667. Further, for those areas where we identified questions regarding compliance, we asked each service's general counsel's office for a legal response to our questions, which we considered as part of our review. On March 30, 2011, on the basis of information developed during our review, GAO issued a legal opinion on the terms and conditions of the legal documents comprising the Picatinny Arsenal EUL. The legal opinion supplements our audit report.

To determine to what extent the services' expectations for their EULs have been realized, we obtained and summarized EUL program information from the services, including information on each EUL's estimated and actual development time frames and financial benefits received through September 30, 2010. For the nine EUL case studies, we obtained and reviewed more detailed information on how the services

¹The three Army EUL case studies were located at Aberdeen Proving Ground, Maryland; Fort Sam Houston, Texas; and Picatinny Arsenal, New Jersey. The three Navy EUL case studies were located at Naval Base Point Loma, California; Naval Base San Diego, California; and Naval Base Ventura County, California. The three Air Force EUL case studies were located at Eglin Air Force Base, Florida (two EULs), and Hill Air Force Base, Utah.

initially estimated expected EUL development time frames and financial benefits and how actual EUL development progress and financial benefits through September 2010 compared to expectations. We mostly relied on the services for the accuracy of the information on EUL development time frames and financial benefits, although we corroborated the information based on our review of EUL legal documentation and escrow account records. In the case studies where the expected development time frames and financial benefits were not realized, we discussed the reasons why with officials at service headquarters and at the installations where the EULs were located. Further, we observed EUL property and, when applicable, development progress at most installations where the case study EULs were located.

To evaluate the services' management of the EUL program, we reviewed and considered Department of Defense and military service guidance, policies, instructions, and practices for managing the EUL program in view of federal internal control standards. We also interviewed officials from the Office of the Secretary of Defense; Army, Navy, and Air Force headquarters; the U.S. Army Corps of Engineers; the Naval Facilities Command; and the Air Force Real Property Agency to discuss the implementation and management of the EUL program. We specifically discussed with these officials how and to what extent they document various secretarial determinations required by section 2667—that the lease does not include excess property; that the lease may not be for more than 5 years unless the service secretary determines that a longer term will promote the national defense or be in the public interest; and that the lease include a provision permitting the service to revoke the lease at any time, unless the secretary determines that omission of such a provision will promote the national defense or be in the public interest. In addition, for the nine case studies, we determined how the service determined and provided for the receipt of the fair market value of the lease interest and reviewed how the leased property was used before the lease was signed. We also discussed with service officials the potential that the leased property might be needed for military purposes during the lease term. Further, we discussed with service officials how and to what extent they monitor EUL program administration costs, and we obtained and compared each service's EUL program administration costs, including the costs of service personnel and consultants used to administer the program, during fiscal years 2006 through 2010, with the total amount of consideration received from each service's EULs through fiscal year 2010.

We conducted this performance audit from May 2010 to June 2011 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.

Appendix II: Enhanced Use Leases by Service as of September 30, 2010

As shown in table 4, the services reported that 17 enhanced use leases (EUL) were in place as of September 30, 2010—the Army reported 7, the Navy reported 5, and the Air Force reported 5.

Table 4: EULs by Service as of September 30, 2010

Count	Service	Location	Year first lease signed	Term in years ^a	Leased property	Expected use of leased property
1	Army	Aberdeen Proving Ground, Maryland	2006	50+	416 acres	Site for office park development.
2	Army	Fort Detrick, Maryland	2006	36.5	10 acres	Site for utilities plant construction.
3	Army	Fort Leonard Wood, Missouri	2001	33	52 acres	Site for business center development.
4	Army	Fort Sam Houston, Texas ^b	2001	50-55	41 acres and 3 primary buildings	Renovation and construction of office space.
5	Army	Picatinny Arsenal, New Jersey	2006	50+	Up to 4 buildings and 120 acres	Renovation of office space and development of a research park.
6	Army	Redstone Arsenal, Alabama	2009	50	468 acres	Site for office and research center development.
7	Army	Yuma Proving Ground, Arizona	2007	50	2,500 acres	Site for construction of vehicle test track.
8	Navy	Moanalua, Hawaii	2004	40	15 acres	Site for commercial center development.
9	Navy	Naval Air Station Key West, Florida	2003	5	Ship docking pier	Commercial cruise ship docking facility.
10	Navy	Naval Base Point Loma, California	2005	5	432,000 square feet in building and storage space	Industrial space for assembly of rocket propulsion fuel tanks.
11	Navy	Naval Base San Diego, California	2008	30	4.8 acres and 1 building	Industrial space to aid in ship construction.
12	Navy	Naval Base Ventura County, California	2007	5	Over 100 acres	Site to off-load and store imported automobiles.
13	Air Force	Eglin Air Force Base, Florida	2006	30	255.5 acres	Site for a wastewater treatment plant and sewage disposal field.
14	Air Force	Eglin Air Force Base, Florida	2007	25	130.8 acres	Site for an airport terminal and rental car services.
15	Air Force	Hill Air Force Base, Utah	2008	50+	499 acres	Site for office and commercial center development.
16	Air Force	Kirtland Air Force Base, New Mexico ^c	2005	50	8.3 acres	Site for office and research center development.
17	Air Force	Nellis Air Force Base, Nevada	2008	50	41 acres	Site for a wastewater treatment facility.

Source: GAO analysis of data provided by the Army, Navy, and Air Force.

^aSome leases include provisions and options that could result in extending the term by many years.

**Appendix II: Enhanced Use Leases by Service
as of September 30, 2010**

^bOn October 1, 2010, as a result of the 2005 Defense Base Closure and Realignment Commission recommendation that DOD establish 12 joint bases by consolidating the management and support of 26 separate installations, Fort Sam Houston, Lackland Air Force Base, and Randolph Air Force Base became Joint Base San Antonio. With the implementation of this joint basing action, the Air Force became responsible for installation support at the joint base, including the administration of the Fort Sam Houston EUL.

^cThe Air Force terminated the Kirtland EUL on December 23, 2010, because of lessee default.

Appendix III: GAO's Legal Opinion regarding the Picatinny Arsenal EUL



United States Government Accountability Office
Washington, DC 20548

B-321387

March 30, 2011

The Honorable Carl Levin
Chairman
The Honorable John McCain
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Ranking Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable Howard P. "Buck" McKeon
Chairman
The Honorable Adam Smith
Ranking Member
Committee on Armed Services
House of Representatives

The Honorable C.W. Bill Young
Chairman
The Honorable Norman D. Dicks
Ranking Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Subject: *Department of the Army—Escrow Accounts and the Miscellaneous Receipts Statute*

The House Committee on Armed Services Report accompanying H.R. 5136, the National Defense Authorization Act for Fiscal Year 2011, 111th Cong. (2010), directs GAO to report to the Defense Committees of Congress on the Department of Defense's implementation of 10 U.S.C. § 2667 by the execution of enhanced use

leases (EULs). H.R. Rep. No. 111-491, at 508 (2010). In the course of our review, we identified legal issues concerning the Department of the Army's use of escrow accounts and indemnification agreements provided for in EULs. This opinion addresses those aspects of the Army's implementation of 10 U.S.C. § 2667.

Section 2667(a) authorizes each Secretary of the armed forces to lease non-excess real property¹ that is under the control of the Secretary concerned and that is not currently needed for public use, provided the lease satisfies certain statutory criteria. 10 U.S.C. § 2667(a). The Army employs the term, "enhanced use lease," to describe leases executed under the authority of 10 U.S.C. § 2667(a) and that require the payment of an annual rental consideration meeting or exceeding certain statutory thresholds that trigger congressional reporting requirements. *See* 10 U.S.C. §§ 2662, 2667(c)(4). Such enhanced use leases also tend to be long-term (30 years or more) with a large scope and scale of development.

During the course of GAO's review, we examined individual EULs executed by the Army with respect to property located at three Army installations: Picatinny Army Arsenal, NJ; Aberdeen Proving Ground, MD; and Fort Sam Houston, TX. Our review of the legal documents comprising the Picatinny EUL raised questions about the compliance of the EUL with 10 U.S.C. § 2667, as well as with the Antideficiency Act, 31 U.S.C. § 1341, and the miscellaneous receipts statute, 31 U.S.C. § 3302(b). We agreed with your staff to deliver a separate legal opinion addressing these issues.

As discussed in more detail below, we conclude that the Picatinny EUL (as defined below) does not comply with 10 U.S.C. § 2667. Specifically, the Army received cash consideration for the Picatinny EUL, and did not deposit it in the special account of the Treasury as required by 10 U.S.C. § 2667(e)(1)(C). By diverting the cash to an escrow account under the control of the Army rather than depositing such amount in the special account, the Army violated the miscellaneous receipts statute, 31 U.S.C. § 3302(b), and by spending such funds the Army improperly augmented its appropriations. In addition, the indemnification provision in an escrow agreement (subsequently removed by amendment) was a violation of the Antideficiency Act warranting the filing of a report in accordance with 31 U.S.C. § 1351. While this opinion pertains primarily to the Picatinny EUL and the ancillary documents executed in connection therewith, to the extent the EULs for the other Army

¹ The term "excess property" means property under the control of a federal agency that the head of the agency determines is not required to meet the agency's needs or responsibilities. 40 U.S.C. § 102(3).

installations are on substantially similar terms as the Picatinny EUL, our conclusions here apply to those EULs as well.²

BACKGROUND

Statutory Framework

Each Secretary of the armed forces may lease certain non-excess real property in exchange for cash or in-kind consideration. 10 U.S.C. §§ 2667(a), (b)(4)–(5). All money rentals received pursuant to leases entered into under 10 U.S.C. § 2667(a) must be deposited into a special account in the Treasury established for the Secretary concerned. 10 U.S.C. § 2667(e)(1)(A)(i). The cash consideration deposited in the special account is available to the Secretary concerned only to the extent provided in appropriations acts and for specific enumerated purposes relating to real property construction, maintenance services, lease of facilities, or payment of utility services. 10 U.S.C. § 2667(e)(1)(c). Conversely, if “in-kind” consideration is received, such consideration may be accepted at any property or facilities under the control, and for the benefit, of the Secretary concerned that are selected for that purpose. 10 U.S.C. § 2667(c)(2).

Picatinny Enhanced Use Lease Agreement and Related Escrow Agreement

The Army entered into a Master Agreement to Lease For Enhanced Use Lease, Research Development and Engineering Command Armaments Research, Development and Engineering Center Picatinny Arsenal, New Jersey, with InSitech Inc., lessee, on September 26, 2006 (Master Agreement). The property subject to the Master Agreement consists of 100,000 square feet of existing facility space, as well as 120 acres of land that is to be developed into a million square feet of administrative, laboratory, and light manufacturing space (Project Site). The Master Agreement provides that the Project Site will be leased in incremental portions as separate parcels pursuant to separate site leases. The site leases and the Master Agreement are collectively referred to herein as the Picatinny EUL. Each parcel is to be

² Our practice when issuing decisions and opinions is to obtain the views of the relevant agencies in order to establish a factual record and to establish the agencies’ legal positions on the subject matter of the request. GAO, *Procedures and Practices for Legal Decisions and Opinions*, [GAO-06-1064SP](#) (Washington, D.C.: Sept. 2006), available at www.gao.gov/legal/resources.html. The record in this case consists of documentation and information provided to us by the Department of the Army with respect to the Picatinny EUL. The record also includes a letter from the Deputy General Counsel, Department of the Army, to the Assistant General Counsel for Defense Capabilities and Management, GAO, dated Nov. 10, 2010 (Army Legal Letter), providing the Army’s legal views on certain terms and conditions of the Picatinny EUL, including the use of escrow accounts under 10 U.S.C. § 2667.

developed pursuant to plans approved by the Secretary of the Army and subject to the terms and conditions provided in each site lease.

The Master Agreement sets forth the terms and conditions under which the Army and the lessee will enter into each site lease. The Master Agreement contemplates that each site lease will be on substantially the same terms and conditions. To the extent there is a conflict between the provisions of the Master Agreement and a particular site lease, the site lease will control. As of October 19, 2010, the Army had entered into two site leases under the Master Agreement. Site Lease 1 was executed on September 26, 2006.³ Site Lease 2 was executed on August 14, 2007.⁴

Under the terms of the Master Agreement, the aggregate cash consideration to be paid by the lessee for all parcels leased under Site Lease 1 and Site Lease 2 is as follows (collectively, Rent Consideration):

“(1) A one-time, lump-sum payment of \$1.7 million dollars (up-front payment), which was paid upon execution of Site Lease 1;⁵

(2) An aggregate annual rent based on operating revenues earned by the lessee from the leased property and calculated according to a pre-

³ See Enhanced Use Lease Research Development and Engineering Command Armaments Research, Development and Engineering Center Picatinny Arsenal, Picatinny, NJ between the Army and InSitech Inc. (Lease No. DACA31-1-06-444 for Buildings 352 and 353), Sept. 26, 2006 (Site Lease 1). Concurrently with the execution of Site Lease 1, the lessee entered into a sublease with Forge Technology, LLC. Under the sublease, the sublessee will renovate and/or demolish the existing buildings leased under Site Lease 1 and construct, develop and use new buildings, pursuant to a site plan approved by the Secretary. Because the terms and conditions of the Sublease are not relevant to our decision here, they are not discussed in this opinion.

⁴ See Enhanced Use Lease Research Development and Engineering Command Armaments Research, Development and Engineering Center Picatinny Arsenal, Picatinny, NJ between the Army and InSitech Inc. (Lease No. AR-E3-07-G-00355 for Building 350), August 14, 2007 (Site Lease 2).

⁵ The Master Agreement provides that as additional site leases are executed, the lessee is required to pay additional up-front payments. See Master Agreement, ¶¶ 1.6.4, 1.6.5, 1.6.7.

determined formula provided in the Master Agreement and each site lease;⁶ and

(3) Supplemental rent of up to \$850,000 per year.”⁷

See Master Agreement, ¶¶ 1.6.3, 1.6.11, 1.6.12.

The Master Agreement characterizes the Rent Consideration as “funds for in-kind service use” and provides that “it is the intent of the parties that the rent may be collected in cash or as in-kind consideration as authorized by [10 U.S.C. §] 2667.” Master Agreement, ¶ 1.6.14. The lessee is required to deposit the Rent Consideration into an individual interest bearing escrow account at Picatinny Federal Credit Union, which acts as the escrow agent. Upon depositing the Rent Consideration into the escrow account, the lessee “shall have satisfied its obligation with respect to the rent payable [under Master Agreement and each site lease], it being understood that [the] lessee shall have no obligation to provide any other and/or additional in-kind consideration.” Master Agreement, ¶ 1.6.14; Site Lease 1, ¶ 4(e)(i); Site Lease 2, ¶ 4(e)(i).

The up-front payment was deposited into the escrow account. The escrow account is in the name of the lessee and the Army. Picatinny Federal Credit Union Account Statements for Oct. 2009 and Nov. 2009. The escrow funds are subject to the terms and conditions of an Escrow Agreement among the Army, the lessee and the escrow agent (Escrow Agreement). No annual rent or supplemental rent had been paid to the Army as of November 10, 2010.⁸ Any interest or proceeds generated by the

⁶ The lessee is required to pay an aggregate annual rent equal to a percentage of the Cash Flow Available for Distribution (CFAD). *See* Master Agreement, ¶ 1.6.3. CFAD is calculated at the end of each calendar year and is equal to the aggregate net revenue generated from the operation of the Existing Buildings leased under site leases, less (1) amounts placed in a reserve account for capital improvements and maintenance expenses, (2) amounts expended by the lessee for certain infrastructure improvements, and (3) a cumulative annual 10 percent return on amounts invested by the lessee in the development of the Project Site. *See* Master Agreement, at 3–4. If CFAD is zero for any given lease year, no annual rent is due and payable. Site Lease 1 and Site Lease 2 each provides for a proportional payment of the annual rent and the supplemental rent. Site Lease 1, ¶ 4(b), (c); Site Lease 2, ¶ 4(b), (c).

⁷ The lessee is also obligated to make supplemental rent payments to the Army, provided the Lessor has generated aggregate net revenue from all leased existing buildings in excess of \$20 million. In such circumstances, the lessee must pay the Army a supplemental rent of \$850,000, less any annual rent paid for that year.

⁸ The Army explained that because the lessee has not generated enough operating revenue to cover its initial investment, there has not been any CFAD to warrant any payment of annual rent or supplemental rent. *See supra* notes 6 and 7.

escrow funds are deemed to be income to Army for income tax purposes. Escrow Agreement, ¶ 3(a). The Army disclaims any ownership in the escrow account, but claims a secured interest in the escrow funds. Escrow Agreement, Recital D. Further, as described in more detail below, the Army exerts control over the escrow account and the escrow funds are utilized for the benefit of the Army.

The Escrow Agreement provides that once the Rent Consideration is deposited into the escrow account by the lessee (or its sublessee): (1) such payment “shall constitute in-kind consideration payments” by the lessee; (2) such payment is to be credited against the total rent owed by the lessee; and (3) the lessee “*shall have no rights*” in or to the escrow funds held in or disbursed from the escrow account. Escrow Agreement, ¶ 2 (emphasis added). The escrow agent may disburse escrow funds either—(1) to a third-party contractor as payment for services rendered by such contractor to property under the control of the Secretary pursuant to a statement of work approved by the Army, or (2) directly as a cash payment to the Army. Escrow Agreement, ¶ 5.

The Escrow Agreement provides for a multi-step process for the disbursement of escrow funds to third-party contractors as payment for services.⁹ Escrow Agreement, ¶ 6. First, the Army delivers to the lessee an “in-kind service request” in the form of a statement of work. The lessee then selects and contracts with a third party to complete the statement of work. Upon completion of the work by the third-party contractor, Army employees from Picatinny’s Department of Public Works inspect the work and notify the lessee whether the work has been satisfactorily completed. If so, the lessee directs the escrow agent to disburse funds from the escrow account sufficient to pay the third-party contractor.

⁹ The escrow funds may be used to pay a third-party contractor for the following services:

- “(a) Maintenance, protection, alteration, repair, improvement, or restoration (including environmental restoration) of property or facilities under the control of the Secretary;
- (b) Construction of new facilities for the Secretary;
- (c) Provision of facilities for use by the Secretary;
- (d) Facilities operation support for the Secretary; and
- (e) Provision of such other services relating to activities that will occur on the leased property as the Secretary considers appropriate.”

Escrow Agreement, ¶ 4.

As of June 2010, \$1,474,635.04 of the escrow funds has been disbursed to pay for various services performed on property under the control of the Secretary. Army Written Responses to GAO Written Questions, dated Jun. 29, 2010, at 6. In addition, we understand that as of such date, Picatinny's Department of Public Works had initiated two other service requests that are anticipated to cost \$248,000. *Id.* at 7.

At the time of execution, the Escrow Agreement included an indemnification provision that stated that the Army and the lessee "jointly and severally agree to indemnify and hold the escrow agent harmless from and against any and all liabilities, causes of action, claims, demands, judgments, damages, costs and expenses (including reasonable attorneys fees and expenses) that may arise out of or in connection with the escrow agent's good faith acceptance of or performance of its duties and obligations under this Escrow Agreement." Escrow Agreement, ¶ 3(i). On July 2, 2009, the parties modified the Escrow Agreement to delete the indemnification provision.

DISCUSSION

The Army asserts that the "cash payment for in-kind service use" it received as Rent Consideration constitutes in-kind consideration under 10 U.S.C. § 2667(b)(4). We disagree. The Army has, in fact, received cash consideration for the Picatinny EUL and under section 2667 is required to deposit such amounts in a special account in the Treasury established for such purpose. The cash consideration was deposited in an escrow account rather than the designated account in the Treasury. We will first discuss the implications of the Army's actions under section 2667 and the miscellaneous receipts statute. Next, we will discuss the indemnification provision contained in the Escrow Agreement and the Antideficiency Act.

The Picatinny EUL and Section 2667

Section 2667(b) of title 10 enumerates the statutory criteria that a lease executed under 10 U.S.C. § 2667(a) must satisfy. Of relevance here is subparagraph (4), which requires that the lease "... provide for the payment (*in cash or in kind*) by the lessee of consideration in an amount not less than the fair market value of the lease interest, as determined by the Secretary[.]" 10 U.S.C. § 2667(b)(4) (emphasis added). The term "payment in kind" is not defined in section 2667; however, acceptable forms of in-kind consideration are described in 10 U.S.C. §§ 2667(b)(5), 2667(c)(1)–(2). Those subparagraphs provide as follows:

(b) Conditions on leases.—A lease under subsection [10 U.S.C. § 2667(a)]—

* * * *

(5) may provide, notwithstanding section 1302 of title 40 or any other provision of law, for the alteration, repair, or improvement,

by the lessee, of the property leased as the payment of part or all
of the consideration for the lease;

* * * *

(c) Types of in-kind consideration.—(1) In addition to any in-kind consideration accepted under subsection (b)(5), in-kind consideration accepted with respect to a lease under this section may include the following:

(A) Maintenance, protection, alteration, repair, improvement, or restoration (including environmental restoration) of property or facilities under the control of the Secretary concerned.

(B) Construction of new facilities for the Secretary concerned.

(C) Provision of facilities for use by the Secretary concerned.

(D) Provision or payment of utility services for the Secretary concerned.

(E) Provision of real property maintenance services for the Secretary concerned.

(F) Provision of such other services relating to activities that will occur on the leased property as the Secretary concerned considers appropriate.

(2) In-kind consideration under paragraph (1) may be accepted at any property or facilities under the control of the Secretary concerned that are selected for that purpose by the Secretary concerned.

10 U.S.C. §§ 2667(b)(5), 2667(c)(1)–(2).

The non-exhaustive list of permissible in-kind consideration provided in the foregoing subparagraphs is consistent with the common definition of “payment in kind,” namely, the “payment for goods and services made in the form of other goods and services, not cash or other forms of money.” *Barron’s Dictionary of Finance and Investment Terms* 506 (6th ed. 2003). When Congress does not specifically define the terms that it uses in a statute, courts often turn to common dictionaries to find the plain, ordinary meaning of a word or phrase. *See, e.g., Mallard v. United States District Court*, 490 U.S. 296, 301 (1989); B-302973, Oct. 6, 2004, at 4–5. While a common dictionary meaning is a helpful aid as we interpret the meaning of the phrase “payment in kind,” we also must interpret the language so that “the statutory scheme is coherent and consistent The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in

which that language is used, and the broader context of the statute as a whole.” *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340–41 (1997) (internal quotation marks and citations omitted); B-318897, Mar. 18, 2010, at 2.

Sections 2667(b)(5) and 2667(c)(1)–(2) are key in discerning the coherent, consistent meaning that Congress intended. These subparagraphs illustrate that the in-kind consideration contemplated by section 2667(b)(4) includes the provision of a service or property. With the exception of the “[p]rovision or payment of utility services,” each example of in-kind consideration detailed by these subparagraphs describes a specific deliverable related to the provision of a service to a property under the control of the Secretary (for example, “[m]aintenance, protection, alteration, repair, improvement, or restoration . . . of property or facilities”) or the provision of a real property facility (for example, “[p]rovision of facilities for use by the Secretary concerned”). 10 U.S.C. §§ 2667(b)(5), 2667(c)(1)–(2).

Where Congress permits the acceptance of funds without requiring their deposit in the special account in the Treasury, the statute is explicit. *See, e.g.*, 10 U.S.C. §§ 2667(c)(1)(D), 2667(e)(1)(B), 2667(e)(3)–(5). Subparagraph (c)(1)(D) permits either the *provision* of utility services or the *payment* of utility services for the Secretary concerned. All other types of in-kind services enumerated in section 2667(c)(1) are for the *provision* of services. 10 U.S.C. § 2667(c)(1) (emphasis added). Section 2667(e)(1)(B) specifies additional instances where cash payments received by the Secretary under a lease need not be deposited in the special account. For example, money rentals received for a lease under section 2667 for agricultural or grazing purposes of land may be retained by the Secretary concerned and expended in such amounts as the Secretary considers necessary to cover the administrative expenses of leasing for such purposes. 10 U.S.C. §§ 2667(e)(1)(B)(ii), 2667(e)(3).

The Army asserts that the use of an escrow account is permissible under 10 U.S.C. § 2667 as long as the account does not alter the lessee’s responsibility to provide in-kind services using the escrow funds. Army Legal Letter, at 9. However, other than the deposit of the Rent Consideration into the escrow account, neither the Master Agreement, Site Lease 1, Site Lease 2, nor the Escrow Agreement specify any in-kind deliverables to be provided by the lessee to property under the control of the Secretary. Rather, the Master Agreement, Site Lease 1, and Site Lease 2 specify that upon depositing the required cash payments into the escrow account, the lessee has “no obligation to provide any other and/or additional in-kind consideration.” Master Agreement, ¶ 1.6.14; Site Lease 1, ¶ 4(e)(i); Site Lease 2, ¶ 4(e)(i). In fact, under the lease terms, a third-party contractor will provide in-kind services only if the Secretary of the Army so opts at some point in the future. Escrow Agreement, ¶ 5. Escrow funds may be disbursed either—(1) as a payment to a third-party contractor for services rendered pursuant to a statement of work issued by the Army or (2) as a direct cash payment to the Army. Once the Rent Consideration is deposited into the escrow account, the lessee has no rights to escrow funds. In fact, for income tax purposes, any interest earned is earned by the Army, another incidence of ownership.

The fact that the Rent Consideration, paid in cash, may ultimately be used to compensate third-party contractors that provide to the Army the types of services that are permissible under 10 U.S.C. § 2667(c)(1) does not change the essential nature of the transaction: the Army has granted a leasehold interest in the Project Site in exchange for cash consideration. The cash consideration has been deposited into the escrow account in satisfaction of the lessee's rent obligations under the lease instead of being deposited in the special account in the Treasury called for by 10 U.S.C. § 2667(e). Such diversion of cash payments is not authorized by 10 U.S.C. § 2667.

The escrow account into which the Army deposited (or caused to be deposited) the up-front payment is similar to the trust at issue in *Motor Coach Industries v. Dole*, 725 F.2d 958 (4th Cir. 1984).¹⁰ In *Motor Coach Industries*, the FAA and the airlines servicing Dulles International Airport entered into an "interwoven set of agreements" designed to fund the purchase of buses for airport ground transportation. *Id.* at 961. FAA agreed to waive certain fees it normally charged the airlines for services the FAA provided at the airport, in exchange for the airlines establishing a trust at a national bank and funding that trust with a "per passenger fee" based on an FAA-approved formula. *Id.* FAA monitored the accuracy of the airlines' payments to the trust and performed most of the administrative duties associated with the collection of the fee. *Id.* Although the airlines were the settlors of the trust, the court found that "the FAA maintained firm control over vital aspects of the trust." *Id.* "The [t]rust's resources were dedicated to the objective of primary importance to the agency—securing suitable buses for Dulles Airport." *Id.* No expenditures from the trust could be made without FAA authorization. *Id.* at 962. Considering these facts, the court observed that "the FAA's hand was visible in all critical aspects of the Trust—its creation, its funding, and its administration." *Id.* at 965. The court also noted that while the airlines were the settlors of the trust and made contributions from their own revenues, "there is every indication that their role was nominal." *Id.* Thus, the court found that the trust moneys were public money.¹¹

The roles of the Army and the lessee here are analogous to those of FAA and the airlines, respectively, in *Motor Coach Industries*. The escrow funds represent

¹⁰ *Motor Coach Industries* involved the challenge of a contract award by an unsuccessful competitor who asserted that the Federal Aviation Administration (FAA) had not followed federal procurement guidelines in awarding a contract for ground transportation at Dulles International Airport. The Fourth Circuit Court of Appeals concluded that the funds channeled by FAA to a trust established by the airlines and used to purchase ground transport buses for Dulles International Airport were public in character; therefore the trust, like FAA was subject to federal procurement guidelines, which had not been followed. *Id.* at 964–65.

¹¹ The court also noted that the trust arrangement undermined the integrity of the congressional appropriations process, enabling the FAA to supplement its budget by millions of dollars without congressional action. *Motor Coach Industries*, 725 F.2d at 968.

payment in full by the lessee of the Rent Consideration. The lessee has no right to the escrow funds. Rather, the escrow funds may be disbursed only in the manner determined by the Secretary. Thus, the Army has control over the disposition of the escrow funds which, except for the payment of expenses of the escrow agent, are used solely for the benefit of the Army. *See, e.g., Scheduled Airlines Traffic Offices v. Dept. of Defense*, 87 F.3d 1356, 1361–62 (D.C. Cir. 1996) (finding that concession fees paid by travel agents into a “Morale Fund” in consideration for government resources, that is, the right to occupy agency office space and to serve as the exclusive on-site travel agent, was “money for the government” and violated the miscellaneous receipts statute). Despite the Army’s disclaimer of ownership of the escrow account, there is no question that the escrow funds are cash consideration for the Picatinny EUL and constitute “money for the government.” Under section 2667, these funds must be deposited in the designated special account in the Treasury. 10 U.S.C. § 2667 (e)(1).

The Miscellaneous Receipts Statute

Under the miscellaneous receipts statute, “an official or agent of the Government receiving *money for the Government* from any source shall deposit the money in the Treasury as soon as practicable without deduction for any charge or claim.” 31 U.S.C. § 3302(b) (emphasis added). As explained above, the cash payment is, in fact, “money for the government.” The requirement for deposit “as soon as practicable without deduction for any charge or claim” applies whether the correct account for deposit is in the general fund of the Treasury or where, as here, the money must be deposited into a specific fund in the Treasury. B-318274, Dec. 23, 2010; B-72105, Nov. 7, 1963. Therefore, the miscellaneous receipts statute required the Army to immediately deposit the proceeds of the Picatinny EUL into the appropriate account in the Treasury. B-307137, July 12, 2006; B-300248, Jan. 15, 2004.

Instead, the Army caused the up-front payment to be deposited into the escrow account. With this action, the Army violated the miscellaneous receipts statute and,

when it expended the funds, it improperly augmented its appropriation.¹² *See* B-307137 (finding that the Department of Energy used uranium sales proceeds (and earnings on those proceeds) in violation of the miscellaneous receipts statute, which resulted in DOE unlawfully augmenting its appropriations when it directed its agent to receive, retain, and use proceeds from the sale of government assets to compensate the agent for expenses it incurred on behalf of the government); B-265727, July 19, 1996 (finding that SEC violated the miscellaneous receipts statute and improperly augmented its appropriations, by subleasing space and arranging for the sublessee to make its payments directly to the landlord). To remedy the situation, the Army must deposit the proceeds from the Picatinny EUL into the appropriate account in the Treasury.

Unfortunately, the Army has expended substantially all of the Rent Consideration with a minimal balance remaining in the escrow account. The Army did not have the authority to use the Rent Consideration to pay for services performed on property under the control of the Secretary. In doing so, the Army augmented its appropriation. The Army should adjust its accounts by transferring funds from an Army account available to pay for services to property under the control of the Secretary to the appropriate account in the Treasury. If the Army finds that it lacks sufficient budget authority to cover the adjustment, it should report a violation of the Antideficiency Act in accordance with 31 U.S.C. § 1351.

The Indemnification Provision and the Antideficiency Act

Prior to its amendment in July 2009, the Escrow Agreement contained a provision pursuant to which the Army expressly agreed to indemnify the escrow agent against all liabilities. Such an open-ended indemnification provision commits the government to potentially unlimited liability and violates the Antideficiency Act, 31 U.S.C. § 1341. *See, e.g.*, B-260063, June 30, 1995. Once it is determined there has been a violation of 31 U.S.C. § 1341, the agency head “shall report immediately to the

¹² We note that had the Rent Consideration been deposited in a special account in the Treasury established for the Secretary as required by 10 U.S.C. § 2667(e)(1)(A)(i), such amounts would be available to the Secretary only to the extent provided in an appropriation act. 10 U.S.C. § 2667(e)(1)(C). Further, the expenditure of such appropriated funds is subject to certain limitations. 10 U.S.C. § 2667(e)(1)(C). For example, at least fifty percent of the proceeds in the special account shall be available for expenditure at the military installation where the proceeds are derived. 10 U.S.C. § 2667(e)(1)(D). In addition, once appropriated, no more than \$500,000 may be expended at a single military installation until after a report on the proposed expenditure is submitted to the defense committees of Congress. 10 U.S.C. § 2667(e)(1)(E). Here, substantially all of the Rent Consideration received to date has been utilized for services at the Project Site. Such amounts may not have been available for expenditure at the Project Site had the Rent Consideration been deposited into the special account as required.

President and Congress all relevant facts and a statement of actions taken." 31 U.S.C. §1351. In addition, the heads of executive branch agencies shall also transmit "[a] copy of each report . . . to the Comptroller General on the same date the report is transmitted to the President and Congress." 31 U.S.C. § 1351. To date, GAO has not received a report from the Army regarding this violation.

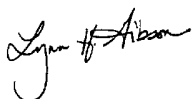
CONCLUSION

The Army did not comply with 10 U.S.C. § 2667 and violated the miscellaneous receipts statute by effectively receiving cash, not in-kind, consideration and depositing such proceeds into an escrow account instead of the special account in the Treasury for such purpose as required by 10 U.S.C. § 2667(e)(1)(C). Simply calling a cash payment "in-kind services" does not make it so. The facts show that the Army received a payment of cash and did not deposit it in the appropriate account in the Treasury. Instead, the Army used the funds as if they were permissible in-kind consideration. As a consequence, the Army violated section 2667, violated the miscellaneous receipts statute, and augmented its appropriations. In addition, the Army violated the Antideficiency Act upon execution of the Escrow Agreement, and although the Army subsequently cured the violation by amending the Escrow Agreement to delete the indemnification provision, a report of the violation is still required.

Accordingly, the Army should transfer the balance of the escrow funds to the appropriate account in the Treasury. With respect to the escrow funds that have been expended to date, the Army should adjust its accounts by transferring funds from an Army account available to pay for services to property under the control of the Secretary to the appropriate account in the Treasury. If the Army finds that it lacks sufficient budget authority to adjust its accounts, it should report a violation of the Antideficiency Act in accordance with 31 U.S.C. § 1351. In addition, with respect to the indemnification provision in the original Escrow Agreement, we encourage the Army to make the necessary report as required by 31 U.S.C. § 1351 as soon as possible. Finally, to the extent the Army has entered into EULs on substantially similar terms and conditions as the Picatinny EUL, the Army should take the same corrective action.

If you have any questions, please contact Susan A. Poling, Managing Associate General Counsel, at (202) 512-2667, or Julia C. Matta, Assistant General Counsel, at (202) 512-4023.

Sincerely yours,



Lynn H. Gibson
General Counsel

Appendix IV: Comments from the Department of Defense



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

JUN 08 2011

Mr. Brian J. Lepore
Director, Defense Capabilities and Management
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Lepore:

This is the Department of Defense (DoD) response to the GAO draft report 11-574, "DEFENSE INFRASTRUCTURE: The Enhanced Use Lease Program Requires Management Attention," dated May 9, 2011 (GAO Code 351491).

The Department appreciates the opportunity to comment. Our detailed comments are enclosed.

The Department concurs with the six recommendations and the Military Services are taking appropriate measures to comply with the GAO's recommendations.

Sincerely,

Dorothy Robyn
Deputy Under Secretary of Defense
(Installations and Environment)

Enclosure:
As stated

**GAO Draft Report Dated May 9, 2011
GAO-11-574 (GAO CODE 351491)**

**“DEFENSE INFRASTRUCTURE: THE ENHANCED USED
LEASE PROGRAM REQUIRES MANAGEMENT ATTENTION**

**DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS**

The GAO recommends that the Secretaries of the Army and the Air Force take the following three actions:

RECOMMENDATION 1: Review all EULs for terms and conditions similar to those that our legal opinion concluded were inconsistent with applicable statutes; determine whether steps are needed to help ensure that the EULs are in compliance with applicable statutes; and, if so, then implement these steps.

DOD RESPONSE: Concur with comment.

The Army and Air Force will review all their EULs executed to date and will amend lease terms and conditions as necessary in order to comply with applicable statutes. The Army and Air Force will also take action to ensure that the amended lease terms and conditions are appropriately incorporated in their documentation of future EULs.

As part of their review of EUL documentation, the Army and Air Force will examine all escrow agreements associated with lessees' obligation to pay in-kind consideration pursuant to 10 U.S.C. § 2667 and amend these documents as necessary and appropriate to clarify the lessee's obligation to provide in-kind consideration for the leasehold interest granted to the lessee by the Army and ensure that the escrow agreement does not amount to constructive receipt of funds in that account by the government.

The DoD does not read the GAO Report and accompanying legal opinion as prohibiting the use of escrow agreements in connection with EUL transactions, provided the terms of those escrow agreements do not amount to constructive receipt of funds in the escrow agreement by the government. Accordingly, the Department contemplates that the Army and Air Force will continue to use appropriately drafted escrow agreements in those EUL transactions where the service determines that doing so is necessary to ensure that the lessee has the financial resources to provide the in-kind consideration owed the United States. In the Department's view, the use of an escrow agreement as part of a EUL transaction represents a reasoned and permissible exercise of agency discretion to implement its statutory authority to collect in-kind consideration from a lessee through use of a commonly used legal instrument that provides substantial protection of the United States' financial interests.

**GAO Draft Report Dated May 9, 2011
GAO-11-574 (GAO CODE 351491)**

**"DEFENSE INFRASTRUCTURE: THE ENHANCED USED
LEASE PROGRAM REQUIRES MANAGEMENT ATTENTION"**

**DEPARTMENT OF DEFENSE COMMENTS
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RECOMMENDATION 2: Take steps to ensure that all EULs provide that if and to the extent that the leased property is later made taxable by state or local governments under an Act of Congress, the lease shall be renegotiated, as required by subsection 2667(f) of Title 10, U.S. Code.

DOD RESPONSE: Concur with comment.

Some existing EULs already contain substantially similar language. In others, the provision was omitted because the lessee interest was already being taxed. Nonetheless, the services will amend their existing EULs to include GAO's recommended language: "if and to the extent the leased property comprising the Premises is later made taxable by State or local governments under an Act of Congress, this lease shall be renegotiated as required by subsection 2667(f) of Title 10, U.S. Code." This language will be incorporated into future EUL legal instruments.

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RECOMMENDATION 3: Review and clarify guidance describing how the FMV of the lease interest should be determined and how the receipt of FMV can best be ensured.

DOD RESPONSE: Concur with comment.

The Army and Air Force will revise their processes for establishing Fair Market Value (FMV) and prepare appropriate guidance. The Army intends to include a requirement that the fair market value (FMV) of the leasehold interest be informed by appraisals as well as competitive pricing obtained through open market solicitations. Additionally, the services shall develop guidance that establishes procedures to verify that in-kind consideration received is not less than the FMV of the leasehold.

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The GAO recommends that the Secretaries of the Army, the Navy, and the Air Force take the following three actions:

RECOMMENDATION 4: Issue guidance on how to determine and document that section 2667 provisions were met prior to entering into an EUL, including the required secretarial determinations and the basis for the determinations.

DOD RESPONSE: Concur.

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RECOMMENDATION 5: Issue guidance on the analyses or documentation needed to show that future leases executed under section 2667 do not include property needed for public use, as is now required by section 2667.

DOD RESPONSE: Concur with comment.

All three services will issue and update their EUL guidance on the analyses or documentation needed to establish that leases executed do not include property needed for public use.

While concurring with the recommendation, the Department does not agree there was a reasonable probability that the Army might have a need for the property it leased at Fort Sam Houston, as asserted by the GAO in support of this recommendation. It is unlikely that the combination of circumstances that occurred after lease execution, including the terrorist attacks of September 11, 2001 and consequent effects on base access/security and Army space requirements, could have been reasonably foreseen.

The Army points out that it formally documents the availability of property for EULs using a Report of Availability and has stated that it will revise applicable guidance to establish and document the basis for a determination that the property proposed for lease is not currently needed, and is not reasonably anticipated to be needed over the lease term, for a public use that would be incompatible with the proposed lease. This guidance will specifically address lease compatibility with existing and anticipated Army and other DoD missions. The Army guidance will also emphasize setting lease terms that are no longer than needed, consistent with project development and financing requirements.

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RECOMMENDATION 6: Develop procedures to regularly monitor and analyze EUL program administration costs to help ensure that the costs are in line with program benefits.

DOD RESPONSE: Concur with comment.

The Department notes that the EUL program, as with any innovative practice, has had a steep learning curve within the DoD as well as within the developing and lending communities. Moreover, resolving issues related to recent economic conditions required an inordinate amount of administrative time to terminate non-performing projects. With experience, the Department anticipates that better performing projects will be identified and execution and administrative costs will be reduced through use of standardized documents and processes. Further, as economic conditions stabilize and improve, developer and financier pools become larger and project times shorten, the Department anticipates that EUL projects will perform better and administrative costs will decline. The Department also notes that there are often benefits to the Department that are not included in the rental consideration that should be considered when comparing program costs and benefits.

While the Air Force has tracked direct project costs from the inception of the EUL program it is developing methodology for base-lining and tracking project and program administrative costs and rates of return. Expected costs and returns will be measured against actual costs and returns over a quarterly time period to better enable the Air Force to forecast and monitor the effectiveness of the EUL program.

The Army has instituted quarterly reviews of the EUL program. Within this existing process, the Army will revise its EUL guidance to require standardization of EUL accounting and reporting of program costs and benefits, including benefits that may not be part of the rental consideration.

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

In addition to the contact named above Laura Durland, Assistant Director; Bonita Anderson; Grace Coleman; Michael J. Hanson; Katherine Lenane; and Gary Phillips made significant contributions to this report.

Related GAO Products

Federal Real Property: Authorities and Actions Regarding Enhanced Use Leases and Sale of Unneeded Real Property. [GAO-09-283R](#). Washington, D.C.: February 17, 2009.

Federal Real Property: Progress Made in Reducing Unneeded Property, but VA Needs Better Information to Make Further Reductions. [GAO-08-939](#). Washington, D.C.: September 10, 2008.

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