THE USE OF PUBLIC-PRIVATE PARTNERSHIPS AS A MANAGEMENT TOOL FOR FEDERAL REAL PROPERTY

HEARING

BEFORE THE

SUBCOMMITTEE ON TECHNOLOGY AND PROCUREMENT POLICY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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THE USE OF PUBLIC-PRIVATE PARTNERSHIPS AS A MANAGEMENT TOOL FOR FEDERAL REAL PROPERTY

MONDAY, OCTOBER 1, 2001

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TECHNOLOGY AND PROCUREMENT POLICY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 3:45 p.m., in room 2154, Rayburn House Office Building, Hon. Thomas M. Davis (chairman of the subcommittee) presiding.

Present: Representatives Davis, Horn, and Turner.

Staff present: Melissa Wojciak, staff director; Victoria Proctor, professional staff member; Amy Heerink, chief counsel; George Rogers, counsel; David Marin, communications director; James DeChene, clerk; Mark Stephenson, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. TOM DAVIS OF VIRGINIA. Good morning, or good afternoon I should say. Welcome to the subcommittee's oversight hearing on the benefits of public-private partnerships for Federal real property management.

I think, as most of you know, the Federal Government is among the world's largest property owners and spends billions of dollars annually to maintain properties. The GSA is one of the primary agencies that controls these assets. Its portfolio is characterized by aging buildings that lack the capability to accommodate new technology and sometime pose health and safety concerns. Agencies often vacate Federal properties and lease costly office space to compensate for the lack of adequate federally owned space.

While hundreds of millions of dollars are spent each year to maintain its buildings, GSA indicates that it still lacks sufficient funds to reduce its deferred maintenance backlog. Furthermore GSA has many buildings with negative net cash-flows.

Currently, GSA has several property management tools that it can employ, including outleasing authorities, disposal of buildings representing a net loss to the Federal Buildings Fund, special pricing and a refocused repair and authorization program. But these management tools can't eliminate the underlying cause of the repair and authorization backlog, which is a lack of funding from Congress.

GSA seeks creative alternatives to improve its Federal property managers' ability to effectively manage its multibillion dollar in-

ventory and address the growing challenges created by deteriorating properties. This will be a daunting task without reforms that will allow the agency to operate in a more modern and businesslike fashion. Therefore, GSA needs broader management authorities in order to efficiently and cost effectively manage its property portfolio. GSA must have the ability to upgrade its properties to their highest and best uses but lacks the capital to do so.

For some properties, the public-private partnerships would be a solution, allowing GSA to leverage its property assets. That's why I cosponsored H.R. 2710 with my good friend, Representative Pete Sessions, a former member of this subcommittee. This bill would allow GSA to enter into public-private partnerships and extend the authority to other agencies in order to facilitate government reform.

Since we have started late, I'm going to ask unanimous consent to put the rest of my remarks in the record and yield to Congressman Turner for his opening statement.

[The prepared statement of Hon. Thomas M. Davis follows:]

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SUBCOMMITTEE ON TECHNOLOGY AND PROCUREMENT POLICY OVERSIGHT HEARING

THE POTENTIAL BENEFITS OF PUBLIC-PRIVATE PARTNERSHIPS AS A REAL PROPERTY MANAGEMENT TOOL

OPENING STATEMENT

OCTOBER 1, 2001

Good morning and welcome to the Subcommittee's oversight hearing on the benefits of public-private partnerships for federal real property management. As most of you know, the federal government is among the world's largest property owners and spends billions of dollars annually to maintain its properties. The General Services Administration (GSA) is one of the primary agencies that controls these assets. Its portfolio is characterized by aging buildings that lack the capability to accommodate new technology and sometimes pose health and safety concerns. Agencies often vacate federal properties and lease costly office space to compensate for the lack of adequate federally-owned space. While hundreds of millions of dollars are spent each year to maintain its buildings, GSA indicates that it still lacks sufficient funds to reduce its deferred maintenance backlog. Furthermore, GSA has many buildings in its portfolio with negative net cash flows.

Currently, GSA has several property management tools that it can employ, including (1) outleasing authorities; (2) disposal of buildings representing a net loss to the Federal Buildings Fund; (3) special pricing; and (4) a refocused repair and alteration program. But these management tools cannot eliminate the underlying cause of the repair and alteration backlog: lack of funding.

GSA seeks creative alternatives to improve its federal property managers' ability to effectively manage its multi-billion dollar inventory and address the growing challenges created by deteriorating properties. This will be a daunting task without reforms that will allow the agency to operate in a more modern and businesslike fashion.

Therefore, GSA needs broader management authorities in order to efficiently and cost-effectively manage its property portfolio. GSA must have the ability to upgrade its properties to their highest and best uses, but lacks the capital to do so.

For some properties, public-private partnership would be a solution, allowing GSA to leverage its property assets. That is why I co-sponsored H.R. 2710 with my good friend Representative Pete Sessions (R-TX). This bill would allow GSA to enter into public-private partnerships and extend this authority to other agencies in order to facilitate governmentwide reform.

A public-private partnership would allow for the federal government to contract with a private sector entity that would lease federal property and provide the financial capital to repair, improve, or redevelop the property. The public and private sectors would then share the revenue generated by the property. This would be an excellent opportunity for the government to acquire the necessary capital to salvage a needed property that would otherwise be neglected. It could gain improved space, lower operating costs, utilization of untapped value of the real property, and increased revenue without federal capital expenditure. GSA's revenues from the partnership would be deposited into the Federal Buildings Fund and could be used for repairs and alterations to other federal real property. The private sector partner would be responsible for managing the property and would have a majority interest in ownership and profits. It could benefit from access to previously unavailable property and earn a potentially high internal rate of return.

There are variations on this concept, as we will hear from the Department of Defense and the Department of Veterans Affairs. Both agencies use partnerships through their respective enhanced-use lease authorities. They can maximize the potential value of properties in their portfolios, which would otherwise be left vacant and eventually deteriorate. In each case, the agency's authority was provided through special legislation that allows it to keep the revenues from the partnership for specified purposes.

Additionally, in the 106th Congress, Senators Fred Thompson and Joseph Lieberman introduced S. 2805, the Federal Property Asset Management Reform Act of 2000, which would have authorized federal agencies to retain proceeds from several types of real property transactions, and used these proceeds to fund other things, including real property improvements.

It is time for Congress to expand GSA's property management authorities so it can effectively administer its valuable property portfolio. I look forward to hearing from our witnesses and exploring these exciting and innovative approaches to federal property management.

The Subcommittee will hear from The Honorable Pete Sessions (R-TX). On our second panel we will hear from Bernard Ungar, Director of Physical Infrastructure Issues at the General Accounting Office; Stephen A. Perry, Administrator of the General Services Administration; Ray DuBois, Deputy Undersecretary of Defense Installations

and Environment; Anatolij Kushnir, Director of the Office of Asset Enterprise Management at the Department of Veterans Affairs; Kim Burke, Principal with Ernst & Young; and Sherwood Johnston III, President of the Building Owners and Managers Association and a Designated Broker with CarrAmerica Realty Corporation. Mr. Perry is accompanied by two supporting witnesses, Mr. Joe Moravec, Commissioner of the Public Building Service, and Mr. David L. Bibb, Deputy Associate Administrator of the Office of Real Property in the Office of Governmentwide Policy. They will also be sworn in and available to answer questions.

Mr. TURNER. Thank you Mr. Chairman. I appreciate the fact you've held this hearing. Obviously, over the last few years, we have had an accumulation of deferred maintenance and underutilized Federal properties and we need to look at new and innovative ways to deal with the limited funding that we've had available for repairs and renovations and alterations of Federal property.

I want to commend my colleague from Texas, Mr. Sessions, for his particular interest and leadership in delving into this area and to offer a piece of legislation that he believes would allow us to move forward by incorporating public-private partnerships through the General Services Administration. I know there was another bill, last Congress, also introduced on the subject that perhaps dealt with it in a little broader way.

Having served with Chairman Steve Horn on the committee that had jurisdiction of this last year, we did have one good hearing, as I recall, on the subject, and Mr. Sessions testified at that hearing. And so I really appreciate the good work that my colleague from Texas has done.

I do recall, Mr. Chairman, last Congress when we had a hearing on the issue, there were two groups that wanted to be heard. One of them was the National Association of State Agencies for Surplus Property, and the other was the National Law Center on Homelessness and Poverty. And I think, for completeness of the record, it might be good for us to incorporate in our record the record of testimony from that earlier hearing in the last Congress, from those two groups who are not able to be here today.

Mr. TOM DAVIS OF VIRGINIA. Without objection, we'll do that.

Mr. TURNER. Thank you, Mr. Chairman. I look forward to hearing from all our witnesses.

Mr. TOM DAVIS OF VIRGINIA. Thank you.

[The prepared statement of Hon. Jim Turner follows:]

Statement of the Honorable Jim Turner
Hearing: "The Use of Public-Private Partnerships as a Management Tool for Federal Real Property"
Subcommittee on Technology and Procurement Policy

October 1, 2001

Thank you, Mr. Chairman. The federal government's real estate portfolio is vast and diverse. For the past 50 years, federal property has been purchased, managed, and disposed of under the authority of the Federal Property and Administrative Services Act of 1949. While the principles established by this law have worked well over the years to assure the American people that the value of federal property will be maximized, it may be time to consider modifying particular aspects of the law to encourage more innovative, modern approaches to management and disposal.

Managers of federal properties confront numerous challenges, including a large backlog of deferred maintenance and obsolete and underutilized properties. These problems have been addressed in recent years in an environment in which limited funding for repairs and alterations have been available, and yet there have been growing demands to improve service. In response to this environment, some have suggested that Congress provide the General Services Administration (GSA) with the authority to experiment in funding alternatives, including public-private partnerships. In these arrangements, the federal government contributes the property and the private sector contributes the capital and financing ability to renovate and restore a building. The General Accounting Office has recommended giving the Administrator of General Services the authority to experiment with this funding mechanism through a pilot program.

This hearing will focus on two federal property management reform proposals. H.R. 2710, the "Federal Asset Management Improvement Act of 2001," introduced Rep. Pete Sessions, my colleague from Texas, allows the GSA to enter into public-private partnerships to lease federal real property, renovate current federal property, or develop new federal property. In addition, the bill directs the GSA to establish property management performance measures and each agency would then monitor its agency's performance against such measures.

The second is a bill introduced in the 106th Congress, S. 2805 the "Federal Property Asset Management Reform Act." This bill is much broader than H.R. 2710, but deals in part with public-private partnerships. It was drafted by the GSA, in collaboration with other agencies, in an effort to streamline and enhance federal property transfers while providing flexibility and creating incentives for agencies to declare property excess.

Rep. Horn held a hearing during the last Congress on this issue. At that hearing we heard testimony from two groups concerned with some of provisions of this legislation -- the National Association of State Agencies for Surplus Property and the National Law Center on Homelessness and Poverty. I would ask that the statements of those organizations be included in the record for this hearing so that it is as complete as possible.

I welcome the witnesses here today and am pleased to see my friend, Rep. Sessions among them. I commend both Mr. Sessions and Chairman Davis for their leadership on this issue. As we look to new approaches, we must remember that federal property is a sacred trust held by the government for the people. It is my belief that it is the government's responsibility to use federal property wisely and efficiently, and when it is no longer needed, the government must assure that its disposal occurs without prejudice or favor.

Thank you Mr. Chairman

Mr. TOM DAVIS OF VIRGINIA. Let me recognize now, if I may, the gentleman from Texas, Mr. Sessions, who introduced this legislation in previous Congresses. I think he is going to be a successful author this time, and I just want to remind everyone he has a sore throat, so bear with him. Thank you.

Mr. Sessions, good to have you with us.

STATEMENT OF HON. PETE SESSIONS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. SESSIONS. Mr. Chairman, thank you so much, and my friend and colleague, the gentleman from Texas, Mr. Turner. I appreciate you both taking time to be here today.

Thank you for noticing my sore throat. I hope my voice lasts. I think that you consider that an opportunity for me to be very brief.

With that said, Mr. Chairman, I'm going to try and read my statement and then see if you've got any questions.

I want to thank both of you for inviting me to testify today concerning my legislation, H.R. 2710, the Federal Asset Management Improvement Act, and other legislation related to the reforming of activities of the General Services Administration.

GSA is a very large enterprise. GSA, like any other government organization, continues to change with time. Today is a great day to address some of those changes that I believe are necessary and prudent. Due to the GSA being largely funded through agency fees, rather than direct appropriations, congressional oversight tends to focus on the crisis of the moment. I believe that it's time for this committee to take a fundamental look at the GSA and the responsibilities exercised by their wonderful Administrator, Steve Perry. GSA has evolved greatly since 1949 but many of GSA's management tools are based on archaic laws and rules. They need to be updated to reflect modern practices.

Before I get too deeply into my statement, I also want everyone to remember the last weeks, 2 weeks ago, terrorist attack on the large urban center that took place in New York City. This same type of attack took place also in 1995 when the Alfred P. Murrah Building was destroyed in Oklahoma City. And that was a GSA building filled with Federal tenants. The terrible disaster in Oklahoma has been reemphasized by the disaster in New York and the Pentagon. The GSA is on the front line when it comes to protecting Federal buildings all over the United States, and I certainly want Administrator Perry to know that every Member of Congress stands ready to assist him as he makes needed adjustments to improve security in our Federal buildings.

Modern property management requires a range of tools in the GSA tool kit. A significant gap in this tool kit is GSA's inability to enter into a public-private partnership with a private entity to further the public purposes for which the GSA was created.

According to GSA's own estimates at the end of 1998, GSA deferred maintenance requirements by almost $5 billion. In other words, GSA needed $5 billion to maintain its inventory of aging buildings and to bring them up to current standards for energy efficiency, Internet connectivity and rentability. If GSA's properties continue to deteriorate, Federal customers will explore their options. A scenario will be created in which more Federal customers

will be driven to pay rent to private landlords. If this happens, GSA will continue to be stuck with more and more deteriorating properties that lose money for the Federal Government, a scenario that wastes taxpayer money.

My answer to this problem is a public-private partnership. In such a public-private partnership, the private sector will be responsible for making the needed improvements, including paying for them. This is an attractive offer to a private investor because if the Federal Government does not want to take occupancy due to changing needs, it does not have to utilize this option. The private sector will then be free to rent the space to another tenant. The private sector is subject to the market and financial risk while the government acquires simply the space it needs.

The public-private partnership addresses: Aging and deteriorating buildings; underperforming properties; and, creates demand for economic performance and accountability.

The government gains, as it will share in net cash-flow and retains proceeds for use as directed.

The private sector receives a corresponding financial reward in terms of a preferred return.

The government provides no financial or space use guarantees. By contributing investment capital, the private sector assumes the risks.

H.R. 2710 will authorize the administrator to enter into such arrangements. The authority also may be delegated to other Federal agencies. In looking at the feasibility of such public-private partnerships, the General Accounting Office concluded that the concept shows great merit to help taxpayers and the agencies that will serve taxpayers to save money and to become more efficient.

I know that GAO is on the next panel, and they will thoroughly describe their findings. They have come to the same conclusion as many who have studied this issue, and that is that public-private partnerships can be a valuable component of modernizing the GSA Federal office buildings.

I know that GSA has a lengthy list of other reforms related to property management generally, and the Federal Property and Administrative Services Act of 1949 in particular. Most of these changes appear both beneficial and uncontroversial. They were proposed by the previous administration and are supported by the current one. I would urge this committee to carefully consider these changes in the law.

Our goals must be simple and clear, to permit the GSA additional tools to improve its inventory of public buildings for the furtherance of its public purposes of providing space for Federal agencies. A workable version of public-private partnership is certainly within our grasp.

I want to thank each of you who is here today and this subcommittee for the heavy lifting that they will do to get this on the floor.

I appreciate your help, Mr. Chairman.

Mr. TOM DAVIS OF VIRGINIA. Mr. Sessions, thank you very much. Thank you.

[The prepared statement of Hon. Pete Sessions follows:]

Statement of Congressman Pete Sessions

Before the Subcommittee on Technology and Procurement Policy
The Honorable Tom Davis, Chair

October 1, 2001

Mr. Chairman and other members of the subcommittee, thank you for inviting me to testify today concerning my legislation, H.R. 2710, the Federal Asset Management Improvement Act, and other legislation related to reform of the authorities of the General Services Administration.

GSA is a very large enterprise. Since it has a permanent and indefinite authorization, GSA has not been reauthorized since 1949. Due to GSA being largely funded through agency fees rather than direct appropriations, congressional oversight tends to focus on the crisis of the moment. I believe that it is time for this committee to take a fundamental look at GSA and the authorities exercised by the Administrator. GSA has evolved greatly since 1949, but many of GSA's authorities are archaic. They need to be updated to reflect modern practices.

Before I get too deeply into my statement, I do want everyone to remember the last terrible terrorist attack on a large urban center in 1995. When the Alfred Murrah Federal Building was destroyed in Oklahoma City, that was a GSA building, filled with Federal tenants. The terrible disaster in Oklahoma has been reemphasized by the disaster in New York and at the Pentagon. GSA is on the front line when it comes to protecting Federal buildings all over the US. I want the Administrator to know that every Member of Congress stands ready to assist him as he makes any needed adjustments to improve security in our Federal buildings.

Modern property management requires a range of tools in the GSA toolkit. A significant gap in this toolkit is GSA's inability to enter into a public-private partnership with a private entity to further the public purposes for which GSA was created.

According to GSA's own estimates, as of the end of 1998, GSA's deferred maintenance requirement was $5 billion. In other words, GSA needed $5 billion to maintain its inventory of aging buildings and bring them up to current standards for energy efficiency, internet connectivity, and rentability. If GSA's properties continue to deteriorate, Federal customers have options. They can pay rents to private landlords in the same real estate market where there is vacant GSA space. If this happens, GSA will continue to be stuck with more and more properties that lose money for the Federal Government. This is the situation that taxpayers are faced with in respect to the General Services Administration -- an ever deteriorating inventory, with an inability to focus on maintenance and upgrades.

My answer to this problem is a public-private partnership (PPP). In such a public-private partnership, the private sector will be responsible for making the needed improvements, including paying for them. This is attractive to a private investor, because if the Federal Government does not want to take occupancy due of changing needs, it does not have to utilize this option. The private sector will then be free to rent the space to another tenant. The private sector is subjected to the market and financial risk, while the government acquires the space it needs.

The public-private partnership addresses the following:

- aging/deteriorating buildings
- vanishing appropriations
- changing facility needs
- underperforming properties
- releasing captive property value
- creates demand for economic performance and accountability
- fulfils private sector investment appetite

The public-private partnership design elements are as follows:

Government:
- conveys long-term leasehold interest to PPP for specific fee
- provides ***no*** financial or space use guarantees
- shares in Net Cash Flow
- retains proceeds for use as directed

Private Sector:
- contributes investment capital
- provides expertise to administer venture
- uses debt financing
- assumes risk of speculative renovation projects
- receives corresponding financial reward (preferred return)

The Property Selection Criteria would include:

- market potential for shared use of the site and/or facilities by the private sector
- investment potential
- the condition of the property and the nature of the continued federal space requirements
- the compatibility of projects with the local community planning objectives and the property's capacity for value enhancement

H.R. 2710 will authorize the Administrator to enter into such arrangements. The authority also may be delegated to any other Federal agency. In looking at the feasibility of such public-private partnerships, the General Accounting Office recently concluded that the concept shows great merit to help taxpayers and the agencies that serve taxpayers save significant amounts of money. I know that GAO is on the next panel, and they will thoroughly describe their findings. They have come to the same conclusion as many who have studied the issue: public-private partnerships can be a valuable component of modernizing both our Federal office buildings and the outdated authorities of the General Services Administration.

I know that GSA has a lengthy list of other reforms related to property management generally and the Federal Property and Administrative Services Act of 1949 in particular. Most of these changes appear both beneficial and uncontroversial; they were proposed by the previous Administration and are supported by the current one. I would urge the committee to carefully consider these changes in law.

I am confident that together, minor issues between the Office of Management and Budget and H.R. 2710 can be easily ironed out. Our goals must be simple and clear: to permit GSA additional tools to improve its inventory

of public buildings for the furtherance of its public purpose of providing space for Federal agencies. A workable version of public-private partnership is certainly within our grasp.

Mr. TOM DAVIS OF VIRGINIA. Now I'm going to call our witnesses, Mr. Ungar, Mr. Perry, Mr. DuBois, Mr. Kushnir, Ms. Burke and Mr. Johnston.

As you know, it is the policy of this committee that all witnesses be sworn before they testify. So if you'd rise with me and raise your right hands.

[Witnesses sworn.]

Mr. TOM DAVIS OF VIRGINIA. Please be seated.

To afford sufficient time for questions if you'd limit your comments to 5 minutes. There are some lights in front of you. The green will go on, you'll get 5 minutes. After 4 minutes, it will turn orange. That gives you 1 minute to sum up. And try to stay within 5 minutes.

Your total testimony is part of the record. We've read that and are basing questions on the totality of the testimony. But it helps us for you to sum up.

We'll start with Mr. Ungar, we'll move with you; and then Mr. Perry, and then straight on down the line. Please go ahead.

STATEMENTS OF BERNARD L. UNGAR, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, U.S. GOVERNMENT ACCOUNTING OFFICE, ACCOMPANIED BY RON KING, MARIA EDELSTEIN, AND LISA WRIGHT SOLOMON, PROJECT TEAM MEMBERS, AND STEVE WARNER, SIGNET PARTNERS; STEPHEN A. PERRY, ADMINISTRATOR, U.S. GENERAL SERVICES ADMINISTRATION, ACCOMPANIED BY JOE MORAVEC, COMMISSIONER OF THE PUBLIC BUILDING SERVICE, AND DAVID BIBB, DEPUTY ASSOCIATE ADMINISTRATOR FOR REAL PROPERTY, OFFICE OF GOVERNMENTWIDE POLICY; RAYMOND F. DuBOIS, JR., DEPUTY UNDER SECRETARY OF DEFENSE, INSTALLATIONS AND ENVIRONMENT, U.S. DEPARTMENT OF DEFENSE; ANATOLIJ KUSHNIR, DIRECTOR, OFFICE OF ASSET ENTERPRISE MANAGEMENT, U.S. DEPARTMENT OF VETERANS AFFAIRS, ACCOMPANIED BY MICHAEL SIMMONS, SENIOR COUNSEL, OFFICE OF THE GENERAL COUNSEL; KIM H. BURKE, PRINCIPAL, ERNST & YOUNG; AND SHERWOOD JOHNSTON III, DESIGNATED BROKER-ARIZONA, CarrAMERICA REALTY CORP., BUILDING MANAGERS ASSOCIATION

Mr. UNGAR. Thank you, Mr. Chairman, Mr. Turner, Mr. Sessions. We are certainly pleased to be here today to discuss the work that we have done at your request, as well as from other Members of Congress with respect to public-private partnerships.

Before I begin my summary, I would like to mention that I am accompanied today by our project team, Ron King, Maria Edelstein and Lisa Wright Solomon. In addition, we did have contract support. Kim Burke from Ernst & Young is a member of the panel, and Steve Warner from Signet Partners is also here, and we appreciate their help in this particularly complex effort.

For many years, as you all have indicated, the General Services Administration [GSA], has experienced significant problems with aged and deteriorating buildings; and I think that can be very easily demonstrated by two projects that we worked on—one in 1991 and one in 2000—almost 10 years apart. And you could take the

1991 report, just change the date on it, and the findings would be the same, which are that GSA does have numerous buildings which are in disrepair and has not had the funding necessary to adequately deal with these problems.

These are problems that the Department of Defense and the Veterans Administration have also faced with their physical infrastructure; and I might note that they do already have authority for enhanced-use leasing.

As a result of the problems that GSA faces and has faced with these buildings, Federal employees and visitors face situations of being in buildings that aren't in the best of condition with respect to, particularly, health and safety problems. Taxpayers end up paying higher costs for operating expenses such as fuel and energy costs. And GSA is losing money on a number of buildings because of either low occupancy or no occupancy, and is at risk of losing money on other buildings in which the tenants are not happy with the conditions that they are in.

In our view, GSA needs to take more aggressive action to deal with this range of problems; and it does not have all the tools necessary to do that. Public-private partnerships provide one tool which could be very useful to GSA.

As has already been indicated, in our review, with the help of our contractors, we did lay out a structure over here on the chart which is also an attachment to our testimony in which a partnership could take place.

In summary, the Federal Government would contribute a property in the form of a lease to a private partner. The private partner would provide cash and/or financing ability to redevelop or renovate the property. That would form the partnership.

Once the partnership began, there would be a cash-flow from the rental payments. There would be operating expenses. You'd be left with a net income after that. After that, we would take out funds for the master ground lease which would go to GSA. Debt service would be repaid.

It would be a replacement reserve to avoid the problem of aged and deteriorating buildings, and the private sector partner would get a preferred return off the remainder for the risk that the private sector partner undertakes. And then the remainder would be shared, an agreed-upon percent between GSA and the private sector partner.

In our review, with the help of our contractors, we looked at 10 properties and found that 8 of them had potential viability as a partnership. There are two reasons for this. Primarily, one, they were in very good locations, locations in which there was a strong Federal and non-Federal demand for the space. And having a non-Federal demand is critical since the government would not guarantee occupancy. In all these locations, fortunately, there was a strong demand in terms of the eight.

Second, the condition of the properties was such that, on a very general and a very quick review, it appeared as though the cost would be—on the order of magnitude, there would be left a sufficient financial return to attract a private sector investor. Now, in our case, we did this quite quickly with the help of our contractors, and we weren't able to do an in-depth study. But we did find that—

at least on the surface, the information would suggest that the projects would be viable; and we suggest that GSA do more study and more in-depth study, particularly on the financial viability of the projects that we did look at.

In sum, we believe that GSA does need to have more tools in its tool kit. It does need to have legislative authority to enter into public-private partnerships. We suggest that this be done on a pilot basis, primarily because this is a very complex undertaking. There are a lot of risks.

While other agencies have had the authority, GSA has not had it in a general sense, and we thought it would be helpful to get some lessons learned and to see what actually happens compared to what's expected to happen under these types of arrangements.

And before entering into these partnerships, we think, again, that GSA would need to further explore the financial viability of them and then use other—look at all the tools that it has at its disposal to assure that appropriate action is taken to the properties that may not be appropriate for a public-private partnership.

Mr. Chairman, that ends my summary. I'd be happy to answer questions at the appropriate time.

Mr. TOM DAVIS OF VIRGINIA. Thank you much.

[The prepared statement of Mr. Ungar follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Technology and Procurement Policy, Committee on Government Reform, House of Representatives

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PUBLIC-PRIVATE PARTNERSHIPS

Factors to Consider When Deliberating Governmental Use as a Real Property Management Tool

Statement of Bernard L. Ungar
Director, Physical Infrastructure Issues

GAO-02-46T

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our report entitled *Public-Private Partnerships: Pilot Program Needed to Demonstrate the Actual Benefits to Using Partnerships* (GAO-01-906, July 25, 2001), which identifies the potential benefits to the federal government of entering into public-private partnerships on real property. We have reported that the General Services Administration (GSA) has a multibillion dollar backlog of deferred maintenance in federal buildings, and that public-private partnership authority could be an important management tool to address problems in deteriorating federal buildings. However, further study of how the partnerships would actually work and of their benefits compared with other options, such as appropriations, is needed. Numerous buildings in GSA's inventory either have or are at risk of having a negative cash flow because of their deteriorating condition. In our report, we recommended that the Administrator of GSA use all available strategies to address the problems of such buildings in GSA's inventory. We also recommended that the Administrator of GSA seek statutory authority to establish a pilot program that would demonstrate the actual benefits that may be achieved from public-private partnerships that achieve the best economic value for the government. GSA's Commissioner for the Public Buildings Service agreed with the findings and recommendations in our report.

In my testimony, I will discuss four issues from our report that you asked us to focus on for this hearing:

- The structure of public-private partnerships;
- factors that indicate a property may be a potential candidate for a public-private partnership;
- benefits of public-private partnerships to the federal government; and
- factors a private-sector entity considers when determining the viability of a public-private partnership and its benefits to the private-sector entity.

In addition, as you requested, I will briefly discuss the authorities available to the Department of Veterans Affairs (VA) and the Department of Defense (DOD) that allow them to enter into ventures with the private sector.

In summary, the basic structure of a public-private partnership would entail the private sector providing cash and financing ability to renovate or redevelop real property contributed by the federal government and each partner sharing in the net cash flow resulting from the property. Location in a strong office real estate market and the demand for federal and non-federal office space are two key factors when considering properties for

partnership opportunities. Potential benefits to the federal government of public-private partnerships include the attainment of efficient and repaired federal space and the conversion of properties that are currently a net cost into revenue producers. Public-private partnerships are essentially financial business deals for the private sector and it would consider the financial benefits of such an arrangement. Unlike GSA, VA, and DOD currently have the authority to enter into joint ventures with the private sector.

To identify the potential benefits to the federal government of entering into public-private partnerships on real property, we contracted with Ernst & Young LLP, who, together with a subcontractor, Signet Partners, developed and analyzed hypothetical partnership scenarios for seven selected GSA buildings. We also contracted with AEW Capital Management, L.P. (AEW) to update a study it had previously done for GSA on the public-private partnership financial viability for three properties in Washington, D.C. For a complete listing of the 10 properties included in our study, see attachment I. Additional information about our methodology, including how the hypothetical partnership scenarios were structured and how the properties were selected, is included in attachment II. We obtained information on the authorities available to VA and DOD by talking with officials from these agencies and by reviewing applicable legislation.

Background

We have suggested that the Congress consider providing the Administrator of GSA with the authority to experiment with funding alternatives, including public-private partnerships, when they reflect the best economic value available for the federal government. Congress has enacted legislation that provides certain other agencies with a statutory basis to enter into joint ventures with the private-sector. This additional property management tool has been provided to VA and DOD. Furthermore, in an effort to provide more agencies with a broader range of property management tools, the Federal Asset Management Improvement Act (H.R. 2710) was recently reintroduced.

Structure of Public-Private Partnerships

The term public-private partnership can be used to describe many different types of partnership arrangements. When we refer to public-private partnerships, we are referring to partnerships in which the federal government contributes real property and a private entity contributes financial capital and borrowing ability to redevelop or renovate the real property. Regarding the structure of the hypothetical partnerships

developed for our study, the federal government and the private sector entity negotiate to agree on how the specifics of the partnership will work, including how the cash flow will be shared to form the partnership. The private partners will generally require a preferred return to compensate it for the risks it is taking in the partnership. This preferred return is generally a percentage of the cash flow; for our study, the contractors used 11 percent for the Washington, D.C. properties and 9 percent for the other properties. The net cash flow is then divided between the private partner and the federal government at an agreed-upon percentage. Attachment III shows graphically how the hypothetical partnerships in our study were structured.

In structuring partnerships for individual properties, it must be remembered that each property is unique and will thus have unique issues that will need to be negotiated and addressed as the partnership is formed. Great care will need to be taken in structuring partnerships to protect the interests of both the federal government and the private sector. In conducting this study, the contractors assumed that certain conditions would govern a public-private partnership.[1] For example, the property must be available for use, in whole or in part, by federal executive agencies, and agreements must not guarantee occupancy by the United States. In addition, the government would not be liable for any actions, debts, or liabilities of any person under an agreement, and the leasehold interests of the United States would be senior to any lender of the nongovernmental partner.

Factors That Indicated Potential Properties for Public-Private Partnerships

There are various factors that indicate whether a property is a potential candidate for a public-private partnership. There must be not only a federal need for space, but also a private-sector demand for space, since the government is not guaranteeing that it will occupy the property. The stronger the market for rental space, both federal and nonfederal, the more likely that the space will be rented and thus producing income. The property must have the ability to provide a sufficient financial return to attract and utilize private-sector resources and expertise. A property in a strong rental market and at a good location is more likely to attract private-sector interest than a property without these characteristics. Another factor is the existence of an unutilized or underutilized asset on

[1] These conditions are based on legislation that was introduced during the 106th Congress, H.R. 3285.

the property, which could be used to increase the value of the property. Several of the properties we studied had vacant land. The existence of excess land on the property that could be used to increase the amount of office space by expanding or building a new building, could increase the opportunity for an income-generating partnership. The property in Seattle, WA, has a deepwater port that the government is not using to its potential but that could be very valuable to another user.

Any partnership would have to conform with budgetary score-keeping rules. Federal budget scoring is the process of estimating the budgetary effects of pending and enacted legislation and comparing them to limits set in the budget resolution or legislation. Scorekeeping tracks data such as budget authority, receipts, outlays, and the surplus or deficit. Office of Management and Budget (OMB) staff indicated that where there is a long-term need for the property by the federal government, it is doubtful that a public-private partnership would be more economical than directly appropriating funds for renovation. In addition, depending on how OMB scores these transactions, some of the scenarios could trigger capital lease-scoring requirements due to the implicit long-term federal need for the space.

Multiple Potential Benefits to the Federal Government Identified

Our study designed a conceptual framework for public-private partnerships in order to identify potential benefits of these partnerships. Our contractors developed and analyzed hypothetical public-private partnerships for 10 specific GSA properties. Multiple potential benefits to the federal government were identified. These potential benefits include the

- utilization of the untapped value of real property,
- conversion of buildings that are currently a net cost to GSA into net revenue producers,
- attainment of efficient and repaired federal space,
- reduction of costs incurred in functionally inefficient buildings,
- protection of public interests in historic properties, and
- creation of financial returns for the government.

Our study did not identify or address all the issues of partnerships that will need to be considered by the decisionmakers and policymakers as partnerships are developed. Before any partnerships are developed, in-depth feasibility studies would have to be done to evaluate partnership opportunities and other options, such as appropriations, to determine which could provide the best economic value for the government. When

deciding whether to enter into a partnership, the government will need to weigh the expected financial return and other potential benefits against the expected costs, including potential tax consequences, associated with the partnership. Any cost associated with vacating buildings during renovation work would also have to be considered in any alternative evaluated. In addition, any actual partnerships involving the properties in our study may be very different from the scenarios developed by our contractors.

Considerations of and Benefits to the Private-Sector Entity

For a public-private partnership to be a viable option, there must be interest from the private sector in partnering with the government on a selected property. A private-sector partner would generally enter a partnership as a financial business decision. While the private-sector entity would consider numerous factors to determine the viability of a public-private partnership, the financial return from the partnership is the critical factor in the decision on whether to partner with the federal government. According to our contractors, about a 15-percent internal rate of return (IRR)[2] would likely elicit strong interest from the private sector in a partnership. However, this is only one factor, and the circumstances and conditions of each partnership are unique and would have to be evaluated on a case-by-case basis by both the private sector and the federal government. For example, a somewhat lower IRR could be attractive if other conditions, such as the risk level, are favorable. In addition, when our contractors discussed possible partnership scenarios with local developers, the developers said that, to participate, they would want at least a 50-year master ground lease.

A public-private partnership would generally be a financial undertaking for the private-sector entity, and the main benefit to it would be financial. With regard to some properties, the private sector may believe it is a benefit to be associated with a particular project if a developer believes that a project is prestigious and might open future opportunities.

According to our contractors, the analysis of the hypothetical partnerships for many of the properties in our study showed a sufficient potential financial return to attract private-sector interest in a partnership arrangement. Our contractors determined that 8 of the 10 GSA properties

[2] The IRR measures the return, expressed as an interest rate, that an investor would earn on an investment.

in our study were strong to moderate candidates for public-private partnerships. This determination was based on the (1) estimated IRR for the private- sector partner in year 10 of the project, which ranged from 13.7 to 17.7 percent; (2) level of federal demand for the space; and (3) level of nonfederal demand for space. The level of demand for space, both federal and nonfederal, affects the level of risk that the space will be vacant and thus non-income-producing. The stronger the local market is for rental space, the more likely the space will be rented and thus produce income for the partnership. The properties that were strong candidates for partnerships were located in areas with a strong federal and nonfederal demand for space, and many had untapped value that the partnership could utilize, such as excess land on which a new or expanded building could be built.

Authorities Available to VA and DOD

Leasing authority is available to VA and DOD.[3] Under VA's enhanced use leasing (EUL) authority, an EUL must enhance the use of the property and provide some space for an activity that contributes to VA's mission or otherwise improves services to veterans. VA receives fair consideration, monetary or in-kind, as determined by the Secretary and the lease term is not to exceed 75 years. For DOD, terms must promote national defense or be in the public interest, and the lease term may not exceed 5 years without the Service Secretary's approval. The lease proceeds may be used to fund facility maintenance and repair or environmental restoration at the military installation where the property is located and elsewhere. According to VA and DOD, their ventures yield both financial and nonfinancial benefits. Financial benefits include receiving below market rental rates and the receipt of cash revenue in some cases. Nonfinancial benefits include maximizing the use of capital assets as well as in-kind benefits such as the use of a child care center at reduced rates. In 1999, we reported on two projects under the VA's EUL authority.[4] In Texas, a private developer constructed a VA regional office building on VA's medical campus. VA then leased land to the developer on the medical campus and the developer constructed buildings on the land and rented space in them to commercial businesses. In Indiana, the state leased underutilized land and facilities from VA to use as a psychiatric care

[3] (38 U.S.C. § 8161-8169) and (10 U.S.C. § 2667)

[4] *Public-Private Partnerships: Key Elements of Federal Building and Facility Partnerships* (GAO/GGD-99-23, Feb. 3, 1999).

facility. The leasing revenue that VA receives from both sites is to be used to fund veterans programs.

Aside from the work we did in connection with our 1999 report, it is important to note that we did not explore these authorities in depth, nor did we examine the budget scoring implications for projects undertaken based on these authorities. Currently, we are examining DOD's implementation of its authority to lease non-excess property and how the military services are using this and other special legislative authorities to reduce base operating support costs. We expect this work to be completed early next year.

This concludes my prepared statement. I would be happy to respond to any questions you may have.

Contacts and Acknowledgments

For information about this testimony, please contact Bernard Ungar, Director, Physical Infrastructure Issues, on (202) 512-8387. Individuals making key contributions to this testimony included Ron King, Maria Edelstein, and Lisa Wright-Solomon.

Attachment I: GSA Properties Analyzed

Property	Tenants	Building size (square feet)	Current occupancy rate (percentage)	Funds from operations, fiscal year 2000	Private partner IRR[a]	Notes
Seattle, WA	Army Corps of Engineers, FBI motor pool, out-lease warehouse space	607,543 rentable (mixed use) 200,000 office	Office: 8% Warehouse: 80% Motor pool: 100%	$3,293,485	17.7%	Army Corps of Engineers believes that it must relocate to a facility that meets seismic standards
Washington, D.C. Federal Office Building 9	Office of Personnel Management (OPM)	768,530 gross 673,924 rentable	98%	$9,922,041	17.3%	Delegated building
Portland, OR	Immigration and Naturalization Service (INS)	137,281 gross 122,505 rentable	50%	$(207,980)	15.7%	May be hard to retain INS at end of lease in fiscal year 2002 if building needs are not addressed
Washington, D.C. GSA HQ	GSA headquarters	710,431 gross 623,233 rentable	100%	$4,456,891	15.3%	
Columbia, SC	Veterans Affairs (VA)	83,640 gross 802,249 rentable	100%	$332,684	14.5%	
Andover, MA	Internal Revenue Service (IRS)	400,502 gross 393,520 rentable	100%	$2,016,191	14.4%	Delegated building—IRS pays its operating costs
Washington, D.C. Federal Office Building 8	Food and Drug Administration (FDA)	522,491 gross 479,840 rentable	100%	$12,362,825	13.7%	FDA to vacate building and return it to GSA in 2002 clear of any environmental hazards
Charleston, SC	Unoccupied	99,695 BOMA	0	$(1,003,372)	13.7%	Building vacant since 1999 due to damage from Hurricane Floyd
Jacksonville, FL	U.S. District Courts U.S. Postal Service	290,855 gross 278,870 rentable	94%	$1,517,038	12.4%	Courts will move to new courthouse in 2002
Minneapolis, MN	Military Enlistment Processing Service (MEPS)	154,049 gross 143,197 rentable	10%	$599,365	10.3%	MEPS plans to vacate building June 2001

[a]In year 10 of a 50-year partnership.

Source: GSA and Ernst & Young.

Attachment II: Methodology

To identify the potential benefits to the federal government and private sector of allowing federal agencies to enter into public-private partnerships, we hired contractors to develop and analyze hypothetical partnership scenarios for 10 selected GSA buildings. GSA's National Capital Region had previously contracted for a study to analyze the financial viability of public-private partnership ventures for three buildings in Washington, D.C. Because the majority of the work for these properties had already been done, we had the contractor update its work on these 3 buildings and selected them as 3 of the 10 GSA properties. To help us select the other 7 properties for our study, GSA provided a list of 36 properties that it considered good candidates for public-private partnerships. In preparing this list of properties, GSA officials said that they considered factors such as the strength of the real estate market in each area, the extent to which the property was currently utilized or had land that could be utilized, and the likelihood of receiving appropriations to rehabilitate the property in the near future. We judgmentally selected seven properties from this list to include properties (1) from different geographic areas of the country, (2) of different types and sizes, and (3) with historic and nonhistoric features.

To analyze the potential viability of public-private partnerships for each of the 10 selected GSA properties, the contractors

- analyzed the local real estate markets,
- created a hypothetical partnership scenario and redevelopment plan, and
- constructed a cash flow model.

In the contractor's judgment, the partnership scenarios were structured to meet current budget-scoring rules and provisions in H.R. 3285, introduced in the 106th Congress. These provisions included the requirements that the

- property must be available for lease, in whole or in part, by federal executive agencies;
- agreements do not guarantee occupancy by the federal government;
- the government will not be liable for any actions, debts, or liabilities of any person under an agreement; and
- leasehold interests of the federal government are senior to those of any lender of the nongovernmental partner.

However, a determination on how the partnerships would be treated for budget-scoring purposes would have to be made after more details are available on the partnerships.

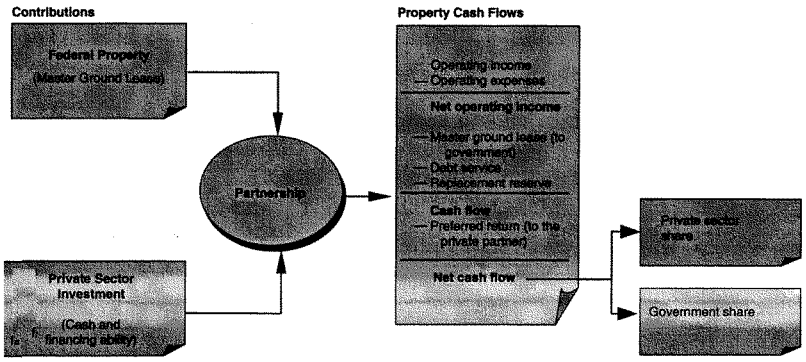
We accompanied the contractor on visits to the seven GSA properties that had not been previously studied. We interviewed, or participated in discussions with, developers and local officials in the areas where the properties were located as well as officials from GSA. We reviewed the contractors' work on the 10 properties for reasonableness but did not verify the data used by the contractors.

The partnership viability scenarios developed for this assignment are hypothetical, and were based on information that was made readily available by representatives of the local real estate markets, city governments, and GSA. Any actual partnerships involving these properties may be very different from these scenarios. In-depth feasibility studies must be done to evaluate partnership opportunities before they are pursued. There may be other benefits and costs that would need to be considered, such as the possible federal tax consequences and the costs of vacating property during renovation in some cases.

This study only looked at the potential benefits to the federal government and private sector of public-private partnerships as a management tool to address problems in deteriorating federal buildings. We did not evaluate the potential benefits of other management tools that may be available for this purpose. We did, however, discuss the implications of using public-private partnerships with OMB representatives.

We did our work between November 2000 and June 2001 in accordance with generally accepted government auditing standards.

Attachment III: Public-Private Partnership Structure



Source: Ernst & Young LLP and Signet Partners.

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Mr. TOM DAVIS OF VIRGINIA. Mr. Perry.

Mr. PERRY. Chairman Davis, Congressman Turner, thank you very much for inviting me to this hearing today to discuss GSA's views on ways to promote efficient and effective stewardship and property management.

If I may, I'll just divert for a moment to thank Congressman Sessions not only for his leadership in this area, but for his public acknowledgment of the good work that GSA people did in the aftermath of the attacks on America and the ongoing work of our security efforts.

I'm pleased to be with you to discuss various reform processes to improve the more than 50-year-old statute under which Federal agencies manage and dispose of their real and personal property assets. GSA believes that agencies should be provided with the freedom to manage their assets, more effectively through the use of appropriate and up-to-date management practices and incentives. Accordingly, we believe that these changes—that certain changes to the property management statutes are necessary to reflect the current needs of the government, as well as current needs of the commercial marketplace; and this will help agencies achieve their missions and goals by reducing the amount of deteriorated vacant or underutilized space in the existing inventory of Federal buildings.

I will submit a longer document for the record as well as this booklet entitled, "Our Federal Buildings," which gives some pictorial indications of some of the more egregious situations that we have today.

Before I begin the rest of my testimony, I'd like to introduce the GSA team that's with me today. It includes Joe Moravec, who is the Commissioner of the Public Building Service; and Mr. David Bibb, the Deputy Associate Administrator for Real Property in GSA's Office of Governmentwide Policy.

Mr. Chairman, first of all, I would applaud the committee and its predecessor for their concern and efforts to improve Federal property management as a priority management reform issue. During the past 2 years, the subcommittee has provided GSA and other Federal agencies the unique opportunity to discuss the problems, policies and procedures surrounding the management and disposal of Federal assets.

As we know, Representative Sessions took the lead on this issue in the House by introducing H.R. 3285, the Federal Asset Management Improvement Act of 1999. In the Senate, Senators Thompson and Lieberman introduced, by request, S. 2805, the Federal Property Asset Management Reform Act of 2000. The bill was developed by GSA in consultation with Federal landholding agencies for the purpose of improving the management of the Federal Government's billions of dollars' worth of real and personal property.

At this hearing, GSA would like to discuss a number of the provisions included in these bills that we believe should be a part of any final legislative package concerned by Congress. Specifically, we believe that the bill should include the following four goals.

Goal No. 1, establish effective property management processes and procedures. GSA would collaborate with other Federal landholding agencies, and OMB to develop what we call asset manage-

ment principles. In addition, each landholding agency would prepare a strategic real property management plan. They would appoint a senior real property officer, and they would contribute to the development and upgrading of GSA's governmentwide real property information data base. And I would emphasize that all of the discussions we're having today apply not only to GSA's role, but to a governmentwide role in this area.

Goal No. 2 would be to help agencies maintain the good physical condition of assets needed to accomplish their agency's mission requirements. GSA believes that the current property act should be amended to provide agencies with common-sense, businesslike practices and techniques to manage their property holdings strategically. The existing act is very limited in helping agencies manage their real and personal property assets. GSA would suggest that agencies have new authorities to address these limitations.

Those authorities would include exchange/sale of real property, subleasing and outleasing, including outleasing to public-private partnerships; and fourth, expanding the exchange/sale of personal property.

On the subject of public-private partnerships, as you know, the L. Mendel Rivers Federal Building in Charleston, SC, which this hearing was originally scheduled to take place at, was favorably reviewed as a pilot for public-private partnership in the General Accounting Office report of July 2001, entitled, "Public-Private Partnerships: Pilot Program Needed to Demonstrate the Actual Benefits of Using Partnerships" and Mr. Ungar just referred to that.

There were several other buildings which were also favorably reviewed in that report. Public-private partnerships could have worked in Charleston, according to the report by GAO, and GSA certainly concurs in that.

GSA strongly supports appropriate use of public-private partnership authority to enable agencies to use private sector resources and the expertise that they could bring to repair and renovate Federal facilities. Any legislative proposal to amend the property act should include criteria that would assure agencies would use public-private partnerships and other tools only in cases where it was economically advantageous to the government to do so.

Public-private partnership authority also should require pretransaction notices to Congress, we believe, in all cases over $2 million.

Goal No. 3 would be to provide incentives to dispose of assets which are not needed for agency mission requirements. GSA recognizes that most agencies simply don't have the opportunity to make such disposals under today's rules. Agencies are not allowed to sell, exchange, sublease or utilize capital assets that may no longer support their agency missions. Consequently, they divert resources to hold these underused and unproductive property that have little or no functional value with respect to their mission.

I'll go to goal No. 4, which is to streamline and enhance existing processes. GSA believes that changing certain sections of the property act could increase efficiency, deliver savings, reduce administrative burdens and streamline Federal asset management processes in a number of areas.

In closing, Mr. Chairman, I would conclude that I would like to say that improving Federal asset management is critical to improving each agency's ability to meet its mission goals and improving governmentwide performance results. At GSA, we have adopted the issue of having this change in legislation completed as our No. 1 priority; it's that important to our operation. We believe that any legislation considered by this subcommittee and the Congress should incorporate life cycle property management practices which we've outlined to provide the asset management principles, incentives and flexibilities needed by agencies to effectively manage their portfolio of assets.

Mr. Chairman, that concludes my statement, and I'm happy to answer questions at the appropriate time.

Mr. TOM DAVIS OF VIRGINIA. Thank you very much.

[NOTE.—The report entitled, "Our Federal Buildings, a Pictorial Report on the Condition of our Federal Buildings and an Update on Their Repair and Alterations Nees," may be found in subcommittee files.]

[The prepared statement of Mr. Perry follows:]

STATEMENT OF

STEPHEN A. PERRY

ADMINISTRATOR

OF

GENERAL SERVICES

BEFORE THE

SUBCOMMITTEE ON TECHNOLOGY AND PROCUREMENT

POLICY

COMMITTEE ON GOVERNMENT REFORM

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 1, 2001

Chairman Davis and Members of the Subcommittee:

Thank you for inviting me to this hearing today to discuss the General Services Administration's (GSA) views on ways to promote efficient and effective stewardship in property management. I am pleased to be with you to discuss various reform proposals to improve the more than 50-year old statute under which Federal agencies manage and dispose of their real and personal property assets. GSA believes that agencies should be provided the freedom to manage their assets more effectively through the use of appropriate and up-to-date management practices and incentives. Accordingly, we believe that changes to the property management statutes are necessary to reflect the current needs of the government and the commercial marketplace. This will help agencies achieve their missions and goals by reducing the amount of deteriorated, vacant, and underutilized space in the existing Federal buildings inventory.

Before I begin my testimony I'd like to introduce the GSA team with me today, which includes Mr. Joe Moravec, the Commissioner of the Public Buildings Service, and Mr. David Bibb, the Deputy Associate Administrator for Real Property in GSA's Office of Governmentwide Policy.

I would like to applaud this Subcommittee and its predecessor on their concern and efforts to improve Federal property management as a priority management reform issue. During the past two years the Subcommittee has provided GSA and other Federal agencies the unique opportunity to discuss the problems, policies, and procedures surrounding the management and disposal of Federal assets. As we know, Representative Sessions took the lead on this issue in the House by introducing, H.R. 3285, the "Federal Asset Management Improvement Act of 1999." In the Senate, Senators Thompson and Lieberman introduced, by request, S. 2805, the "Federal Property Asset Management Reform Act of 2000." This bill was developed by GSA in consultation with Federal landholding agencies for the purpose of improving the management of the Federal Government's billions of dollars worth of real and personal property.

GSA would like to discuss a number of the provisions included in these bills that we believe should be a part of any final legislative package considered by the Congress. We also appreciate your continued interest and support of GSA's efforts to provide Federal agencies with the appropriate management practices and incentives, and look forward to working with the members of the Subcommittee and others in Congress to ensure legislation is passed this Congress to provide these authorities governmentwide.

Background.

The Federal Property and Administrative Services Act of 1949, as amended (the Property Act) is the law that governs the use and disposal of most classes of

Federal real and personal property. This law has served Federal agencies for more than 50 years without significant revision. However, certain elements of the Property Act do restrict the Government's ability to adapt many "best practices" that are now common, every day business practices for the commercial sector. GSA believes the law needs to be amended to provide for the use of these efficient and effective practices that satisfy the current needs and requirements of the Federal agencies.

For example, effective asset management requires that agencies consider all phases of the life cycle (i.e., acquisition, use, and disposal) of property. However, the current Property Act is heavily oriented toward only the disposal phase. Additionally, most agencies lack a full range of policy guidance, accountable management structures, information on their property holdings, and planning processes necessary to manage their property holdings effectively in support of their missions.

We believe that any legislation considered by Congress should address these shortcomings and incorporate a strategic perspective into property management decisionmaking during all phases of the property's life cycle. Specifically, any bill should achieve the following goals:

Goal #1 - Establish Effective Property Management Processes and Procedures.

- Asset Management Principles. Life cycle asset management should be emphasized through the issuance of governmentwide real and personal property Asset Management Principles (AMPs). These principles will serve as the baseline for agencies in their decisionmaking processes. Also specific principles should be considered when entering into outlease arrangements.
- Strategic Real Property Planning. Real property assets are vital to accomplishing many agencies' goals. Legislation should require agencies to develop asset management plans to ensure that decisions on their real property holdings through all life cycle phases are consistent with and supportive of the agency missions, strategic goals, and objectives.
- Senior Real Property Officer. Each landholding agency should appoint a Senior Real Property Officer to oversee and ensure that assets meet strategic objectives, to ensure the observance of AMPs, to prepare asset management plans and to generally coordinate agency real property functions and processes. Many corporations clearly recognize the importance and value of their real property and have placed strategic emphasis on asset management. Government landholders should do the same.
  In the personal property area, agencies already have Property Management Officers to provide this level of support.

- Governmentwide Real Property Information Database. A foundation of any coordinated asset planning/management effort is a database of reliable information regarding the needed assets. Agencies should be required to maintain and use the information to support sound capital asset management decisions government-wide and assure the reliability of the information system.

Goal #2 – Help Agencies Maintain Assets Needed to Accomplish Agency Mission Requirements.

More and more, Federal managers are being encouraged to improve agency performance through the use of good management practices linked to their strategic goals. GSA believes that legislation should be drafted to provide agencies with common sense, businesslike practices and techniques to manage their property holdings strategically.

As mentioned previously, the focus of the current Property Act is oriented toward the disposal phase of assets. It has been very successful in providing an orderly way to dispose of surplus property. However, the Act's success has been limited in helping agencies manage their real and personal property assets that are needed for their missions.

To improve this situation, GSA suggests you consider legislation that would give agencies several new authorities, such as:

- Exchange/Sale of Real Property. Authorize landholding agencies to exchange or transfer property with other Federal agencies and enter into agreements with non-Federal entities to exchange or sell property as a means of acquiring replacement property better suited for their mission purposes.
- Subleasing. Authorize agencies to sublease unexpired portions of government-leased property.
- Outleasing. Authorize agencies to outlease to the private sector assets that must remain in Federal ownership and underutilized portions of non-excess government-owned property to ensure full use and optimum performance of assets. Under certain circumstances, such outleasing arrangements could take the form of public private partnerships to use private sector resources and expertise to repair and renovate Federal facilities.
- Exchange/Sale of Personal Property. Expand existing authority for agencies to replace personal property or acquire services that perform the functions of such replacement property.

On the subject of public-private partnership, as you know, the L. Mendel Rivers Federal Building in Charleston, SC was favorably reviewed as a pilot for a public-private partnership in the General Accounting Office Report of July 2001, titled Public-Private Partnerships: Pilot Program Needed to Demonstrate the Actual

Benefits of Using Partnerships. Public-private partnership could have worked here according to the GAO.

GSA supports appropriate uses of public-private partnership authority to enable agencies to use private sector resources and expertise to repair and renovate their Federal facilities.

A legislative proposal should include criteria to assure that agencies use public-private partnership and other tools (i.e., exchange/sale, subleasing, and outleasing) in an economically advantageous manner to the government. Public-private partnership authority should also require pre-transaction notices to Congress in all cases over $2 million.

Goal #3 - Provide Incentives to Dispose of Assets Not Needed for Agency Mission Requirements.

As Federal agencies and programs evolve, facilities need to change accordingly. The average age of Government-owned buildings is now over 50 years old and many have not been adequately maintained. As a result, many buildings have become inefficient and functionally obsolete.

Unlike the private sector, most Federal agencies have no opportunity to obtain the equity that may be recoverable from the disposal of underused or obsolete property and apply the proceeds toward meeting their on-going facilities needs. This results from the fact that these agencies are simply not authorized to sell, exchange, sublease or outlease capital assets that no longer support their missions, and to use the proceeds for new replacement or capital projects. Consequently, agencies have to divert resources to hold such underused and unproductive property when in fact those resources could be used to improve other facilities that continue to support agency missions. This has resulted in agencies not optimizing property holdings and retaining assets that have little or no functional value to their missions. Legislation should be considered which would include a catalyst for sound asset management decisionmaking, and permit agency use of proceeds as follows:

- Personal Property. Authorize agencies to retain proceeds from the sale of surplus personal property to offset direct and indirect disposal costs.
- Real Property. Authorize agencies to retain the bulk of proceeds from real property transactions and allow such funds to be used to offset direct and indirect disposal costs and in meeting agency capital asset needs.

Goal #4 - Streamline and Enhance Existing Processes.

As mentioned earlier, the Property Act has been in existence for over 50 years, and the fundamental provisions governing property assets have generally remained unchanged. GSA's review of the Property Act has led us to identify

other opportunities to redefine various sections of the Act, which could deliver savings to the government. GSA believes that making changes to these policies could increase efficiency, deliver savings, reduce administrative burdens, and streamline Federal asset management processes. Below are some of the changes that should be considered by the Subcommittee:

- Historic Preservation Conveyances. Permit qualified non-profit institutions to be eligible to receive surplus real property for historic preservation purpose. An example would be that a non-profit institution could obtain Federal land or a building for use as a historic monument when it was no longer needed by the Federal Government and if a State or local government was not interested in or financially able to maintain the property. The non-profit institution would be required to maintain it under the historic preservation statute.
- Congressional Review of Negotiated Disposals of Surplus Property. Eliminate obsolete limitations and the requirement for explanatory statements on personal property negotiated sales and increase from $100,000 to $2 million the value threshold for explanatory statements concerning real property.
- Property for Homeless Assistance. Streamline the process associated with making real property available for homeless assistance purposes under Title V of the McKinney-Vento Homeless Assistance Act while protecting the rights and priority consideration of homeless groups.

Closing.

In conclusion, I would like to say that improving Federal asset management is critical to improving each agency's ability to meet its mission requirements and improving governmentwide performance results. Any legislation considered by this Subcommittee and Congress should incorporate the life cycle property management practices outlined here to provide the asset management principles, incentives, and flexibility needed by agencies to effectively manage their portfolios of real and personal property assets. This will lead to better use and maintenance of needed Federal property and a reduction in unneeded Federal property. Again, thank you for the significant steps the Subcommittee members have taken to highlight the need for property reform. We look forward to working with you to ensure that legislation is passed this Congress.

Mr. Chairman, this concludes my statement. I am happy to answer any questions you or other Subcommittee Members may have.

Mr. TOM DAVIS OF VIRGINIA. Mr. DuBois.

Mr. DUBOIS. Thank you, Mr. Chairman, Congressmen Turner, Sessions, Horn, again for giving me this opportunity to address unique DOD legislative authorities contained in Title 10 that permit the Department to pursue public-private ventures for military housing, base utilities and our newest authority for enhanced-use leasing.

As you know, for years the Department has allowed our installations and facilities to deteriorate due to competing budget priorities and underfunded requirements. Much of our infrastructure is old in various stages of decline. The average age of facilities across the Department is over 41 years.

Without adequate sustained recapitalization, the facility performance degenerates. It also impacts negatively our operational readiness, and mission support suffers. Service life is lost and total costs rise. But we understand that appropriating more money for these efforts will not, by itself, bring us up to the state of readiness we aspire to in a timely manner.

Secretary of Defense Rumsfeld has made it quite clear that he intends to significantly change how we do business in the Department, and we believe that public-private partnerships and enhanced-use leasing can be effective tools in this effort.

As you know, through the diligent efforts several years ago—1996, I believe—Congressman Joel Hefley of Colorado and Solomon Ortiz of Texas aided us and worked with Congress to provide the Department with significant new authorities to use private sector expertise and capital to eliminate a serious shortage in quality, affordable housing for our military families. Using the housing privatization authorities, we developed projects that provide higher-quality housing, faster and at less cost than traditional methods.

Our policy requires, however, that privatization for the sake of privatization is not the appropriate answer. It must yield at least three times the amount of traditional MILCON, or military construction, for the same amount of appropriated dollars.

The 11 most recent military family housing privatization projects, which are described in my written statement, leveraged appropriated military construction dollars at a rate of almost seven to one. We have 16 projects currently in solicitation, and an additional 43 projects have been identified to Congress as privatization candidates.

We have in the Department over 1,600 utility systems. By "utility," I mean water or water treatment, gas and electric which are available for privatization. The sooner we get out of the business of running utility systems and turn them over to public-private or private sector professionals, the sooner we can focus our attention and dedicate our assets and resources to our core missions.

The 2001 National Defense Authorization Act also enacted amendments to the Department's leasing statute that gives us broad authority to outlease real property and facilities on military installations in exchange for cash payments and in-kind services.

These public-private partnerships can come in different forms. There's no cookie cutter or one-type-fits-all. A base commander could share an office building on the base with a company willing to renovate and maintain that building in lieu of a lease, in lieu

of lease payments, a scenario very similar to that being envisioned for a GSA building in Congressman Sessions' bill.

Or an installation may outlease land to a company for the construction of a commercial hotel that can also be used to house overnight travelers on government business, a concept that is already in place via special legislation at Wright-Pat Air Force Base in Ohio, home to our friend Dave Hobson.

A third example involves the construction of a private office park and a warehouse operation on military land whereby the base gets the use of part of the warehouse space and the entrepreneur also agrees to pay for the renovation and repair of certain on-base properties to include historic structures greatly in need of rehabilitation. A project of this nature is being developed at Fort Leonard Wood in Missouri at this time.

There are many other examples at the Defense Department to include Fort Sam Houston in San Antonio, TX, where it recently announced a partnership with local real estate and environmental firms to redevelop and lease over 465,000 square feet of unused buildings that comprise the old Brooke Army Medical Center and the Beach Pavilion Complex.

Another San Antonio, TX, example is the Brooks Air Force Base so-called City Base Project, again, a demonstration project enabled by legislation passed by Congress known as the Base Efficiency Project, here again, a transaction which includes transferring 1,310 acres of land and all the facilities comprising Brooks Air Force Base to the city of San Antonio, wherein will evolve a high-technology business park. But unlike a traditional real estate transaction, where there is an exchange of land for money or other consideration with no continuing relationship between the parties, the Brooks City Base transaction establishes a partnership between the city of San Antonio and the U.S. Air Force.

Out in Honolulu, HI, a 450-acre part of the Pearl Harbor Naval Base called Ford Island is another example of where we will outlease land for commercial use.

In conclusion, Mr. Chairman, we are particularly appreciative of H.R. 2710, wherein both you and Congressman Sessions provide us with new authority that complements and enhances our existing Title 10 authorities, providing the Department with additional tools to derive more value from our real property assets.

Thank you very much, Mr. Chairman. I'm happy to answer questions.

Mr. TOM DAVIS OF VIRGINIA. Thank you very much.

[The prepared statement of Mr. DuBois follows:]

HOLD UNTIL RELEASED

BY THE COMMITTEE

STATEMENT OF

MR. RAYMOND F. DUBOIS, JR.

DEPUTY UNDER SECRETARY OF DEFENSE

(INSTALLATIONS AND ENVIRONMENT)

BEFORE THE SUBCOMMITTEE ON

TECHNOLOGY AND PROCUREMENT POLICY

OF THE HOUSE GOVERNMENT REFORM COMMITTEE

October 1, 2001

Introduction

Mr. Chairman and distinguished members of this Subcommittee, thank you for the opportunity to discuss the Department of Defense's public-private partnership initiatives. I will address the DoD-unique legislation contained in Title 10 of United States Code that permits the Department to pursue public-private partnerships for military housing, utilities privatization, enhanced-use leasing and some specific projects we have initiated to date.

Rationale for Pursuing Public-Private Partnerships

For years we allowed our installations and facilities to deteriorate due to competing budget priorities and ill-defined requirements. Last year's Installations Readiness Report showed 69% of the Department's facilities have serious deficiencies or do not support mission requirements. Much of our infrastructure is old and in various stages of decline. Our average facilities' age across the Department is 41 years. Without adequate sustainment and recapitalization, facility performance degenerates, operational readiness and mission support suffer, service life is lost, and total costs rise.

While this Administration is committed to restoring our installations and facilities to perform as designed, the Department recognizes that we need to find additional ways to leverage our real property assets to improve morale, boost readiness, transform defense capabilities and upgrade aging facilities that do not rely solely on direct appropriations. We must restore the readiness of inadequate facilities, modernize facilities to meet future challenges, and dispose of obsolete facilities. We feel that public-private partnerships in the form of utilities and housing privatization, enhanced-use leasing and two other site specific special legislative initiatives at Brooks AFB, TX and Ford Island, HI will result in great benefits to DoD and the taxpayer.

Factors that Contribute to Successful Public-Private Partnerships

Generally speaking the Department must have land and/or buildings that are available for development with sufficient market appeal to attract one or more private sector or public entities. The local real estate market in a community will generally dictate the demand for the property and its ability to attract and utilize private sector resources and expertise to fund and construct the project.

The project itself must be of the size and scope that would permit a sufficient rate of return to the developer for the project to be accomplished. This means that it is essential that long-term leases be authorized to permit the developer to amortize his costs over a range of 25 to 50 years and beyond.

Finally, the projects must conform to OMB budgetary and scoring rules.

Benefits to DOD and the Private Sector

Public-private partnerships can unleash the untapped value of real property assets by taking underutilized land and buildings and putting them to productive use. These partnerships can transform old buildings and underutilized land from cost generators into cost savers. Public-private ventures can eliminate ongoing maintenance and repair expenditures and provide the opportunity to enhance military readiness and quality of life without expending appropriated funds that then can be used elsewhere.

The bottom line is the Department minimizes its risk and maximizes its potential benefit through the acquisition of better office space, warehouses, the provision of utilities, housing, etc. The private sector assumes the financial risk in order to reap a greater financial reward.

Need for Housing Privatization

About sixty-one percent of DoD's housing inventory in the continental United States is substandard, totaling over 163,000 units. Fixing this problem using only traditional military construction would take over 18 years and cost as much as $16 billion. Recognizing this problem, Congress, in 1996, provided the Department with significant new authorities to use private sector expertise and capital to accelerate the improvement of government-owned housing and help us eliminate a serious shortage of quality affordable housing. Last year Congress extended the housing privatization authorities to December 31, 2004. Using these privatization authorities, we are continuing to develop projects that provide higher quality housing both on and off base, faster and at less cost than traditional methods. The eleven most recent projects awarded leveraged military construction dollars at a combined rate of almost 7: 1. Tapping this demonstrated potential through continued use of housing privatization is essential in order to achieve our 2007 goal. Our policy requires that privatization yield at least three times the amount of housing as traditional military construction for the same amount of appropriated dollars. As our recent projects have demonstrated, this leveraging is normally much higher. Eleven housing privatization projects have been awarded to date:

Naval Air Station Corpus Christi, Texas/Naval Air Station Kingsville, Texas:
The Navy used the investment authority to construct 404 new units off base in the Corpus Christi area. A $32 million project, the Navy invested $9.5 million and will share in the profits upon sale. During the term of the project agreement, Service members have priority access to the units and occupy the housing at preferential rents. The project was awarded in July 1996, and has been completed.

Naval Station Everett, Washington:
The Navy used the investment authority to construct 185 units off base at NS Everett. A $20 million project, the Navy invested $5.9 million and will share in the profits upon sale. During the term of the project agreement, Service members have priority access to the units and occupy the housing at preferential rents. The project was awarded in March 1997, and has been completed.

Lackland, AFB, Texas:

The Air Force used the land lease authority and will provide a direct loan and limited guarantee of the private first mortgage to construct 420 new units on Lackland AFB. This is a $41.9 million project with a scored amount to the Air Force of $6.2 million. The Air Force guaranteed the first mortgage against default caused by a base closure, downsizing, or significant deployment. The project was awarded in August 1998, and is under construction.

Ft. Carson, Colorado:

DoD's first whole base project is located at Fort Carson, CO. The Army leased its land at nominal rent and transferred 1,823 existing housing units to the private sector developer who will renovate those units and also construct 840 new units. The Army will provide a limited guarantee of the private loan against a default caused by base closure, downsizing, or significant deployment. The private sector will own and operate the project. This is a $228.6 million project with a scored amount to the Army of $10 million. The project was awarded in September 1999, and residents are now occupying new and renovated homes.

Robins AFB, Georgia:

The Air Force is privatizing a total of 670 units, including constructing 370 new units and renovating 300 existing units that it transferred to the private sector developer. The Air Force provided 66 acres of land which the developer will exchange with the City of Warner Robins for an 88.5-acre parcel to support the new housing. This is a $54.3 million project was awarded in September 2000, and is now under construction.

Dyess AFB, Texas:

This project will provide the Air Force with 402 new units of off-base at Dyess AFB. The Air Force will provide a first mortgage loan and the developer will provide the land and cash equity. This is a $35.3 million project. The project was awarded in September 2000, and is now under construction.

Marine Corps Base - Camp Pendleton, California (Phase 1):

The Marines project involves the renovation of 512 existing units and the construction of 200 new units. The Marines will lease approximately 92 acres of land supporting the 512 units and approximately 37 acres of vacant land for construction of the new units. This is a $83.3 million project. The project was awarded in November 2000, and is now under construction.

Naval Air Station Kingsville II, Texas:

The Navy entered into a limited partnership with a private developer to obtain 150 new units for 30 years (government option to terminate after 15 years) on developer-owned land. The Navy invested $4.3 M and provided a $2.4 M Government second mortgage. The total cost of this project is $14.5 million. The project was awarded in November 2000, and is now under construction.

Naval Station Everett II, Washington:

The Navy entered into a limited partnership with a private developer to obtain 288 new units off-base in Everett, Washington for 30 years. The Navy invested $12.2 million. The total cost of this project is $42.2 million. The project was awarded in December 2000.

Elmendorf, AFB, Alaska:

The Air Force utilized its land lease authority and provided a direct loan and limited first mortgage to support the renovation, demolition and new construction of 828 units on base at Elmendorf. This is a $91.7 million project. The project was awarded March 15, 2001.

Naval Complex San Diego, California:

The Navy received approval for a family housing privatization initiative to privatize 3,248 units. This project includes privatizing 2,660 existing units, renovating 1,058 of the privatized units, demolition and replacement of 812 privatized units, and construction of 588 new units. The total cost of this project is $261.8 million. The project was awarded August 8, 2001.

We have an active process of gathering and disseminating the lessons that we have learned from our previous projects so that we can apply that knowledge to future projects, including the 16 projects currently in solicitation totaling about 22, 500 units. (Projects in solicitation include: Fort Hood, Texas; Fort Lewis, Washington; Fort Meade, Maryland; Kirtland AFB, New Mexico; Goodfellow AFB, Texas; NC South Texas, Texas; NC New Orleans, Louisiana; MCAS Beaufort/MCRD Parris Island, South Carolina; MCLB Albany, Georgia/MCB Camp Lejeune, North Carolina; NC Hampton Roads, Virginia; Patrick AFB, Florida; Wright-Patterson AFB, Ohio; Dover AFB, Delaware; Stewart Army Subpost, New York; NC Pennsylvania Regional, Pennsylvania; Little Rock AFB, Arkansas). Additionally, 43 projects comprising over 51,500 units have been identified to Congress as privatization candidates.

The Department has also learned a number of other lessons concerning how to best structure housing privatization projects from our initial solicitations and work with the private sector. To evaluate the projects we have awarded and to monitor performance at ongoing projects, we have developed a formal Program Evaluation Plan (PEP) as a tool to evaluate projects awarded under the Military Housing Privatization Initiative. Under the Program Evaluation Plan, financial and management data is collected and reviewed semi-annually to identify best business practices, ensure the well-being of the program, assess the performance of individual projects, and gauge service member satisfaction with privatized housing. The first semi-annual data submittal of the Program Evaluation Plan was received in late March 2001. The information included in this report was reviewed and analyzed, the results are being provided to DoD senior management, OMB, our Congressional review components. The results of this analysis will be reflected in our future public/private sector ventures.

In FY 2002 and beyond we will work on completing the existing 16 projects we currently have in solicitation and to pursue the remaining 43 planned projects. The rate of housing privatization is steadily increasing and the acceleration continues in the FY 2001 Housing Master plans developed by the Services. We also plan to work with Congress to obtain permanent statutory authority to make privatization a cornerstone in DoD's housing program and implement the President's Management Agenda for FY 2002 which places priority on achieving more housing privatization through public-private partnerships.

Utilities Privatization

The Department is committed to modernizing and upgrading utility distribution systems through public-private partnerships in our Utilities Privatization program. Military installations are the deployment platforms that support all of our military operations and to that end, utility distribution systems are the backbone of that platform. We believe that through public-private partnerships we will obtain the appropriate level of expertise and badly needed investment capital to make the necessary improvements to our utility infrastructure and increase its reliability and efficiency.

There are over 1600 utility distribution systems available for privatization in this program. The sooner we get out of the business of running utilities systems and turn them over to private or public-sector professionals, the sooner we can focus the attention we dedicate to them on our core missions. Using the authority granted to us by Congress in section 2688 of title 10 United States Code, our third quarter reports for fiscal year 2001 show that the Services have privatized 23 systems and determined that another 48 systems are not economical to privatize. Requests for proposals (RFPs) have been issued for an additional 702 systems. Lessons learned from these solicitations have shown that this process is extremely complex and often controversial—taking longer than originally anticipated. Additionally, the utility industry has expressed concern that too many solicitations were being advertised simultaneously, saturating the market. Therefore, we have asked the Services to slow down the process of issuing RFPs. This may require revising our goal to privatize all eligible systems beyond the current September 2003 date. Ultimately, we believe utilities privatization will allow our installation commanders to better support the missions of the Services' operational commands and spend less time worrying about running these utility systems.

Enhanced-Use Leasing

Recently enacted amendments to section 2667 of title 10, United States Code, the Department's leasing authority, contained several enhancements that greatly improve the opportunity for the military services to outlease real property and facilities on military installations and the benefits they can obtain therefrom.

Section 2812 of H.R. 5408 enacted into law by Public Law 106-398, significantly revised section 2667, particularly in its treatment of in-kind consideration. The law still requires the lessee to pay, in cash or in-kind, consideration in an amount that is not less than the fair market value of the lease interest, as determined by the Service Secretary. However, Section 2812 expands the categories of in-kind consideration that the Service Secretary may accept in lieu of cash for the property leased, to include the construction of new facilities. Further, the Service Secretary may now accept in-kind consideration for any property or facility under the control of that Service, rather than just at the installation where the property was leased. Cash proceeds are still subject to further appropriation, but they are now available for an expanded variety of base operating support functions including the construction or acquisition of new facilities.

These enhancements provide the Military Services with exceptional tools to maximize the utility and value of our underused real property assets. The ability to spend cash consideration on a greatly expanded list of base operating support functions, including construction, and the ability to accept a greater array of in-kind services, creates practically limitless out-leasing opportunities. Examples of these opportunities include, but are not limited to, the creation of new or joint-use opportunities for office space, warehouses, hotels/temporary quarters, vehicle test tracks, wind tunnels, energy generation plants, recreational playgrounds, sports venues, etc. Additional benefits can accrue by accepting base operating support or demolition services as in-kind consideration; thereby, reducing the appropriations needed to fund those activities. Finally, the enhancements to section 2667 also provide opportunities to make better use of historic facilities and improve their preservation as both cash and in-kind consideration may be used for those purposes.

Examples of Ongoing Enhanced-Use Leasing Projects

Portsmouth Naval Shipyard, NH:

The Navy is wants to outlease a former seven-story prison at Portsmouth Naval Shipyard, NH. This 264,000 square foot historic property, vacant since 1974, is being considered for development by a prospective the lessee for high-tech office use. Consideration, for the most part, will be in-kind such as the provision of maintenance, repair and improvement of the property and/or the provision of facilities operations and support services. This enhanced-use lease will benefit the Navy by: improving the shipyard's property utilization; reducing the cost of Navy ownership; reducing shipyard man-day rates which include real property overheads; and, by stimulating the local job market by providing employment for hundreds of new workers.

Fort Sam Houston, TX:

On August 28, 2001, Fort Sam Houston, Texas, announced a partnership with local real estate and environmental firms to redevelop and lease 465,000 square feet of unused buildings comprised of the old Brooke Army Medical Center (BAMC), the Beach Pavilion Complex and two other buildings, all historic assets. In exchange, the developer assumes all maintenance and historic preservation costs. This partnership, involving the signing of three unprecedented lease agreements, was made possible by the new authority granted in Section 2667 of Title10 United States Code. This partnership between the Army and several private ventures embodies a unique and creative approach for optimizing cost savings and maximizing the use of existing facilities, to include historic properties. Equally important is that these leases will provide direct financial dividends of $253 million over the lease term to the Department of Defense, in addition to preserving and improving our historic facilities.

Special Legislation

The Department requested and received authorization to proceed with two projects that encompass greater authorities than those in Section 2667 of title10:

Brooks AFB, TX:

The Brooks City Base Project is a DOD demonstration project resulting from enabling legislation passed by Congress known as the Base Efficiency Project. The proposed transaction with the City of San Antonio includes approximately 1,310 acres of land and all facilities comprising Brooks AFB. The Air Force will create the Brooks City-Base, which will evolve into a high-technology business park, referred to as the Brooks Technology & Business Park. Unlike a traditional real estate transaction where there is an exchange of land for money or other consideration with no continuing relationship between the parties, the Brooks City-Base transaction will establish a partnership between the City and the Air Force. The primary focus of the Brooks City-Base is on reducing the costs of providing base support to Brooks AFB. The legislation provides the Air Force with the opportunity to convey real property to the City and leaseback only mission-essential facilities while retaining priority access to quality of life service facilities.

Ford Island, HI:

The authorizing legislation in Title 10 of United States Code allows the Navy to lease or convey property in Hawaii to private entities in exchange for needed facilities and services on Ford Island, a 450-acre part of the Pearl Harbor Naval Base that became readily accessible with the completion of a bridge in 1998. Locating functions on Ford Island will increase the efficiency of operations, decrease maintenance costs, and reduce congestion on the entire naval complex. In addition, the Navy seeks to improve the quality of life for service members by improving their work, housing, and leisure facilities. Currently, the Navy plans to lease up to 75 acres of land on Ford Island for commercial use, and envisions part of the island to be developed as a visitor destination for Navy events. The Navy intends to use the privatization authorities created by the special legislation and the military housing privatization initiative to substantially reduce its actual costs in terms of appropriated funds, and to reduce the time required to complete work to an anticipated 12-year development period. The Navy estimates that it could fund $88.5 million, or 16.1 percent of the total costs, from the fee simple conveyance or leasing of underutilized land parcels. A further $158.8 million could be funded by private investment under the housing privatization initiative, and $13 million through nonappropriated funds, leaving $290.6 million, or 52.8 percent of the total outlay to be funded through appropriated military construction funds.

Future Enabling Legislation

During this past year, we have actively solicited ideas from the Services, our public employees, private industry and local communities to improve the operation and management of our installations. Based upon this feedback, the Administration has submitted the Efficient Facilities Initiative legislation to allow the Department to achieve an approximately 25 percent reduction in base infrastructure. This legislation is key to allowing the Department to more efficiently support force structure, increase operational readiness and facilitate new ways of doing business. A major part of this legislation is the tools for Efficient Operation of Military Installations which provides a number of specific authorities which would permit the Military Departments to explore ways of supporting their missions and their people more effectively, and at less cost, while maintaining operational readiness. It is modeled after the Brooks Air Force

Base Development Demonstration Project. A key component of this legislation is the ability for the Department to sell land or even whole bases to the public or private sector, and lease back only that portion that DoD needs, thereby permitting local economic development on the remainder of the base.

Framework for Action

America's security depends on installations and facilities that support operational readiness and changing force structures and missions. We will continue to transform our installations and facilities into those required for the 21st Century, both through increased resources and through better use of existing resources. We will capitalize on the strengths of the private sector through housing and utilities privatization. We will also develop a plan for managing underutilized property and facilities and actively explore opportunities for outleasing.

We look forward to continued collaboration with Congress and welcome your ideas for identifying additional opportunities to provide the right quality and quantity of installations in the most cost-effective manner.

Conclusion

This concludes my prepared testimony. In closing, Mr. Chairman, I sincerely thank you for giving me this opportunity to describe the Department's public-private partnerships initiatives that are designed to enhance our installations and improve the quality of life for our soldiers and their families.

Mr. KUSHNIR. Good afternoon, Chairman Davis, Congressmen Turner, Sessions and Horn. Thank you for inviting me to this hearing on the benefits of public-private partnerships as real property management tools and to discuss the Department of Veterans Affairs' experience in this area.

Before I begin my testimony, I would like to introduce Mr. Michael Simmons, who is with me today. Michael is Senior Legal Counsel in the Department's Office of General Counsel. Michael's considerable experience in VA's loan privatization sales program provided the legal expertise necessary to successfully undertake these transactions and to further develop the enhanced-use leasing program within the Department.

Since the enactment of the Department's enhanced-use leasing authority in 1991, over $250 million worth of private investment has been secured in VA facilities and properties. This investment has resulted in positive, tangible enhancements to the VA mission and program. Through the enhanced-use leasing program we have secured office space for veterans' benefit centers, upgrades to our health care facilities, transitional housing for our homeless veterans, electricity and other energy products through cogeneration plants for our medical centers, high-tech medical equipment for our veterans, onsite child care centers for our employees, as well as parking for our patients and veterans having business at VA hospitals and facilities. We have been able to obtain these services and upgrades without increasing our capital budget.

More importantly, these projects have resulted in actually reducing operational expenses without having to undertake long-term obligations or commitments of VA resources.

Briefly, VA is the second largest department in the Federal Government in terms of employees. It has a unique mission, the delivery of comprehensive assistance and benefits to the Nation's veterans and their families. VA is the major landholding agency, as well, with an extensive and diverse portfolio of properties, including over 23,000 acres of land, over 46,000 buildings at approximately 270 locations, in addition to over 550 leased spaces nationwide.

To manage its property, VA uses all the traditional authorities available to Federal agencies. However, in many instances, these authorities do not adequately address the needs of a specific mission or development issue. Because of these limitations, exacerbated by ongoing budgetary constraints, privatization and income generation programs have become increasingly important to the Department's efforts. To obtain significant operating cost reductions and pursue alternative funding sources for veterans' programs, VA is constantly developing and implementing new programs, such as enhanced-use leasing program.

An enhanced-use leasing program is, in essence, a cooperative arrangement for the development of VA property under which VA property is made available to the public or to a private entity through a long-term lease. The leased property may be developed for non-VA and/or VA uses, and in return for the lease, the Department obtains fair consideration in the form of revenue, facilities, space, services, money or other in-kind consideration.

In implementing the enhanced-use leasing authority, VA has discovered several key points to developing a successful private-public development program. The single most important is the enabling statute itself. This authority must provide sufficient flexibility to allow the agency to be innovative in its approach to secure private investment into its facilities.

While preserving the integrity of the governmental process, that agency implementation procedure must be tempered so as to be responsive to the broad span of market, environmental political and legal issues that arise in any large-scale development of property. Agency officials involved in the process must be committed to the effort's success, and while attempting to be responsive to the legitimate demands of the private sector, they must remain committed to structuring each transaction in a manner that will not impact future operational decisions nor commit the agency to long-term financial obligations.

Finally, these transactions can succeed only if they're founded on sound business decisions from both the public and the private sector perspectives.

To accomplish these objectives, the agencies must participate fully as equals with the developer lessee in the project's development, financing and in the local community review.

Finally, in stovepiping project development, investing control over any particular program development within a single office really ignores the multiple legal, fiscal and program issues that arise from such a development. Our experience has been, successful implementation of this type of authority is dependent upon developing a coordinated approach that not only includes all the various offices and disciplines involved, that is, the legal, the contracting, the facility development, but also has a strong link to our agencies', our Department's strategic objectives.

That concludes my oral remarks. Thank you very much.

Mr. TOM DAVIS OF VIRGINIA. Thank you very much.

[The prepared statement of Mr. Kushnir follows:]

DEPARTMENT OF VETERANS AFFAIRS ENHANCED-USE LEASING PROGRAM

STATEMENT OF ANATOLIJ KUSHNIR

DIRECTOR, OFFICE OF ASSET ENTERPRISE MANAGEMENT

BEFORE THE SUBCOMMITTEE ON TECHNOLOGY AND PROCUREMENT POLICY

COMMITTEE ON GOVERNMENT REFORM

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 1, 2001

Introduction

In June 2001, Deputy Secretary, Dr. Leo Mackay formally dedicated the Mountain Home Energy Center, VA's first privately financed and operated energy plant – and the first in the Federal Government using this type of public/private development authority and financing structure. This *state-of-the-art* energy facility, designed in harmony with the historic Beaux Arts campus architecture at the James H. Quillen VA Medical Center at Mountain Home, will serve, for many years to come, the energy needs of the VA Medical Center, the East Tennessee State University's James H. Quillen College of Medicine and others in the local community. The lessee in this project is a special purpose entity specifically established to finance, develop and then operate the co-generation plant. Because of the structure of the public/private venture, VA is not only a purchaser of energy from, but also benefits from revenue generated from third party sales.

This unique initiative will result in a 25% reduction in energy consumption at the VA Medical Center. From a budget perspective this will save VA more than $11.5 million in discounted recurring costs and more than $17.5 million in life-cycle costs – with no capital budgeting requirements for VA (cost savings of over $35 Million). The VA Medical Center will also receive a percent of the revenues from energy sales to non-VA customers. Our projected revenues from this plant will be in excess of $5 million. The VA Medical Center plans to utilize the savings and revenues to support improved access to medical center-based primary care and community-based outpatient clinics. The plant also has dual back-up power systems,

each of which can provide 100% of the VA Medical Center's power needs in an emergency – two levels of back-up power that the Medical Center does not have today. This equates to low risk, cost savings, cost avoidance and more reliable delivery of health care to veterans.

From a real estate management perspective, the results of this transaction were nothing short of spectacular. With that dedication, VA leveraged over $50 million of financial benefits from a parking lot that was appraised by the Department at $300,000. More importantly, other than leasing the site, the Department made no long-term commitments or obligations regarding the purchase of energy or future VA activities or presence at the facility. While the terms were fixed for VA purchase of energy for the entire enhanced-use lease term of 35-years, the transaction provided VA with the flexibility to purchase its future requirements based on its future needs without the need for long-term VA guarantees or termination liabilities.

The Department was able to achieve these benefits because of a unique asset management tool called the "enhanced-use leasing authority." Using this authority, VA is able to develop and then incorporate a capital asset management program into its strategic mission objectives. This capital asset management program relies upon a central principle that each VA-controlled property must be managed in a manner that promotes or enhances a VA program or mission. Such management may be either by direct VA-use or by its redevelopment by non-VA (public or private) users. I would like to take the next several minutes to tell you about the enhanced-use leasing program as it has been developed within the Department.

Background

The Department of Veterans Affairs, the second largest department in the federal government in number of employees, has as its unique mission the delivery of comprehensive assistance and benefits to the nation's veterans and their families. VA, through its Veterans Health Administration, is one of the largest direct providers of health care in the world. The Department is also a major land holding agency, with an extensive and diverse portfolio of properties including over 23,000 acres of land and over 5,000 buildings at approximately 270 locations, in addition to over 550 leased spaces nationwide.

To manage its property, VA uses all of the traditional authorities available to federal agencies. However, in many instances these authorities do not adequately address the needs of specific mission or developmental issues. Because of these limitations, exacerbated by on-going budgetary constraints, privatization and income-generation programs have become increasingly important to the Department. In an effort to obtain significant operating cost reductions and pursue alternative funding sources for veterans programs, VA is constantly developing and implementing new approaches, such as enhanced-use leasing.

Traditionally, VA properties have been viewed as cost centers. In contrast, the enhanced-use leasing concept was designed to:

- encourage VA program and facility managers to view VA property holdings as program resources and potential revenue centers;
- attract other public or private sector investment in VA facilities through broad-based market-based opportunities rather than upon reliance upon federal programs;
- place available VA property into more productive uses;
- enable VA to acquire otherwise unaffordable services or facilities; and
- allow VA to realign its property holdings to reflect program requirements in a way that provides the greatest return to the Department and the Government.

What is Enhanced-Use Leasing and What Makes it Work?

Simply, enhanced-use leasing is a cooperative arrangement for the development of VA property under which:

- VA property is made available to a public or private entity through a long-term lease;
- the leased property may be developed for non-VA and/or VA uses; and
- in return for the lease, the Department obtains fair consideration in the form of revenue, facilities, space, services, money or other "in-kind" consideration.

The Department has specific authority to enter into these types of arrangements. Originally enacted in the fall of 1991, the enhanced-use leasing authority is now codified at Section 8161 through Section 8169 of title 38, United States Code. The technical elements of this authority are:

- the term of an enhanced-use lease may be up to 75 years;
- the site to be leased must be controlled by the Secretary;
- all uses must be consistent with and not adversely affect the mission of the Department;
- VA may use "minor" construction funds (up to $4 million) as a capital contribution in connection with an enhanced-use lease;
- VA may purchase services, space or facilities in connection with an enhanced-use lease.
- VA must hold a public hearing at the location of any proposed enhanced-use lease to obtain veteran and local community input
- VA must provide two notices to its congressional oversight committees prior to entering into an enhanced-use lease.

One of the major elements of the enhanced-use leasing authority is that unlike traditional federal leasing authorities in which generated proceeds must be deposited into a general treasury account, the enhanced-use leasing authority provides that all proceeds (less any costs that can be reimbursed) are returned to medical care appropriations. The ability to keep proceeds created an economic incentive for VA and its property managers to fully utilize their existing capital assets and to begin to view these assets as potential resources to fund needed programs or facility requirements. To underscore Congress' intent to provide VA with sufficient latitude to undertake and practice asset management, the statute addresses several key legal issues commonly identified as critical to successful public/private transactions by:

- providing the Department with the ability to enter into long-term agreements so as to enable amortization of private sector capital investments;
- clarifying the ability of the Department to undertake this authority from the myriad of other substantive and procedural laws relating to government procurement, management and disposal of property or services;
- enabling the Department to enter into these agreements in a timely fashion to address market demands;
- providing the Department with the flexibility to address a broad spectrum of market and financial conditions to address specific project requirements so long as the activity was within established statutory requirements and Department mission.

Finally, central to the enhanced-use leasing authority is its close coordination with and reliance upon the local government and community as full partners in the development process. There are two aspects to this participation. First, in order to maximize project efficiencies and minimize development costs, the Department relies, to the greatest extent possible, upon local building codes, safety requirements, construction standards and local government inspection services as they pertain to any non-VA development. If the project involves direct VA control over the management and operation of a facility or if VA occupies a significant portion of the enhanced-use development, the project is considered in the context of applicable VA standards. In such instances, VA requirements are reviewed in the context of how such standards integrate with applicable local codes and standards.

The second, and perhaps the more important reason why enhanced-use leasing stresses local government and local community involvement is to assure that the development is integrated in the local planning process. Close integration enables VA to spot any potential community concerns (scope and intensity of the development, traffic impacts, business impacts, etc.) and to address those issues early on in the planning and development process.

What types of projects have worked and why?

Obviously, sound development economics are the foundation of enhanced-use projects. But some factors within VA's control can contribute to the likelihood of success.

Enhanced-use leasing works best when government requirements can be defined in private sector terms. Examples: a VA administrative facility is not significantly different from a commercial office building; and transient lodging for outpatients or families visiting a VA hospital is not unlike a typical budget hotel. This allows the private sector to construct and operate in its customary manner. VA then benefits from the efficiencies of organizations and delivery processes that have been honed over time by the developer/lessee. VA can also improve the value of its projects by working to reduce project uncertainties, private sector risk and the cost of borrowing capital. This can be achieved through a variety of means such as use of local building codes, VA participation in entitlement discussions with local authorities, or addressing the concerns of potential financing sources early in the development process.

To date, VA has successfully completed a number of project types, including:

- office buildings
- co-generation facilities
- parking facilities
- community nursing homes
- senior living residential facilities
- health care support facilities
- child development centers / elder day care centers
- single room occupancy housing (homeless shelters)
- management and operation of VA golf courses

Lessons Learned

In implementing its enhanced-use leasing authority, VA has discovered several key points to developing a successful public/private development program. The single most important is the enabling statute itself. This authority must provide sufficient flexibility to allow the public entity to be innovative in its approach to secure private investment into its facilities. While preserving the integrity of governmental processes, that public entity's implementation procedures must be tempered so as to be responsive to the broad span of market, environmental, political, and legal issues that arise in large-scale development of property. The public entity officials involved in the process must be committed to the effort's success, and while attempting to be responsive to the legitimate demands of the private sector, they must remain committed to structuring each transaction in a manner that will not obligate future appropriations and federal programs. To accomplish this objective, the public entities must participate fully as equal partners with the developer/lessee in project's development, financing and local community review.

Finally, "stovepiping" project development by vesting control over program development within a single office ignores the multitude of legal, fiscal, and program issues that arise from such development. Successful implementation within an agency is enhanced by establishing project teams with representatives from all of the various departments and disciplines involved.

Mr. TOM DAVIS OF VIRGINIA. Ms. Burke.

Ms. BURKE. Thank you, Mr. Chairman and members of the subcommittee, for allowing me the opportunity to share my views regarding the potential benefits of these partnerships. I stand united with the rest of the panel in support of the benefits of these partnerships.

My name is Kim Burke. I'm a principal with Ernst & Young in the real estate advisory services group, advising both Federal and private sector clients. Prior to that I served at both OMB and CBO.

This February, GAO selected Ernst & Young, together with Signet Partners, to evaluate and quantify the benefits that might be obtained if public-private partnership authority were granted to GSA. I served as the manager for this project and have served on similar projects for DOD and GSA.

Since the other panel members have discussed the existing programs and partnership structures, I'd like to focus my testimony and share with you lessons learned from our study and from Ernst & Young's prior work with private entities, as well as State and local governments in two areas.

First, considering different types of partnerships, and second, considerations for the implementation in partnership authority. For types of partnerships, what conditions would the private sector look for? First, financial attractiveness, including the ability of the partnership to generate a sufficient return on investments. Second, control of the project and other ground lease terms. Third, the risk level of the investment. Fourth, the potential for multiple uses. Fifth, condition and size of the property. And sixth, market demand.

They would also look at such factors as adding diversity to their own portfolio and whether such a partnership would enhance or maintain an existing business relationship that they had with a Federal Government.

What would the government look for? One criterion is getting the project done faster than it might otherwise be possible, or a quick infusion of private sector capital to maintain Federal infrastructure, and tapping into the private sector experience to leverage and enhance Federal service delivery.

Which type of deal is best? The form of each partnership must be carefully evaluated on a case-by-case basis to determine the best economic value and mission enhancement for the Federal Government and how to best leverage both the government and the private sector resources and expertise.

Let's consider three options: first, joint ventures where the partners share in the future project returns. These might be considered when a property is undervalued under current market conditions, and the government could then share in appreciation in the value of the site; or if a property is considered high risk by the private sector, thus requiring a higher return, then such a venture would allow the government to also share in the higher return.

Second, a ground lease might be considered when the cash proceeds from a transaction are not available for retention by the agency, or if the partner in the transaction brings special expertise or services considered by the government to have high value for mission enhancement.

Third, creation of a special purpose entity might be considered when shared space would result in the sharing of knowledge to enhance the Federal missions such as shared resources for a hospital and lab or research space.

The questions from the committee asked for issues for GSA to consider in implementation. Some of the examples are consistent program implementation, including consistent guidance to field offices and other agencies. This is particularly important in cases such as H.R. 2710, where the GSA Administrator could delegate the authority to other agencies. Consistency is also needed to identify potential sites and in developing standardized partnership proposal evaluation process; taking time to complete property-specific market research to identify the best target use and potential users of the property and the true expected development costs, including remediation and other land use costs, is also important.

The government must also navigate Federal requirements including compliance with the Historic Property Act, Environmental Protection Act, OMB scoring rules and circulars and congressional notifications and public hearings.

Finally, fair and open competition to select qualified partners, attracting partners through identification of properties with high market appeal, ensuring deal terms are eligible for private sector financing and securitization; and of course, controls must be designated for monitoring and protecting the Federal interests.

In closing, we've seen partnerships work to the benefit of State and local entities. We've seen them on the Federal level at RTC, at HUD, DOD and VA. They're good for the government. They're good for business and they're a way to provide a low-cost economic stimulus for communities across America.

This concludes my prepared remarks. I'd be pleased to answer any questions. Thank you.

Mr. TOM DAVIS OF VIRGINIA. Thank you very much.

[The prepared statement of Ms. Burke follows:]

WRITTEN TESTIMONY OF

KIM H. BURKE

PRINCIPAL

ERNST & YOUNG

BEFORE THE

HOUSE COMMITTEE ON GOVERNMENT REFORM

SUBCOMMITTEE ON TECHNOLOGY AND PROCUREMENT POLICY

AT AN OVERSIGHT HEARING ON

THE POTENTIAL BENEFITS OF PUBLIC-PRIVATE PARTNERSHIPS AS A REAL PROPERTY MANAGEMENT TOOL

OCTOBER 1, 2001

My name is Kim Burke, I am a Principal with Ernst & Young in the real estate advisory services group. Thank you for inviting Ernst & Young, LLP ("E&Y") to participate in this oversight hearing to allow us to share some of the findings from our analysis of the potential benefits of public-private partnership authority. In February 2001, the U.S. General Accounting Office ("GAO"), on behalf of the GAO's Physical Infrastructure ("PI") team, selected E&Y, together with a subcontractor, Signet Partners, to evaluate and quantify the prospective benefits that might be obtained if public-private partnership authority were granted to the General Services Administration ("GSA") and other agencies. I served as the E&Y engagement manager for this project. I have also served on similar projects for the Department of Defense ("DoD") and the GSA.

With GAO, E&Y and Signet Partners analyzed the following seven properties in conducting our study: Federal Center South (Seattle, WA), 511 Building (Portland, OR), IRS Service Center (Andover, MD), L. Mendel Rivers Federal Building (Charleston, SC), VA Regional Office Building (Columbia, SC), Jacksonville Courthouse (Jacksonville, FL), and Federal Office Building (Minneapolis, MN). For each of these properties, we estimated the likely impact on and return to the federal government of entering into public-private partnerships to replace, rehabilitate, improve, and/or redevelop the existing property. In conducting this study, we used the following approach:

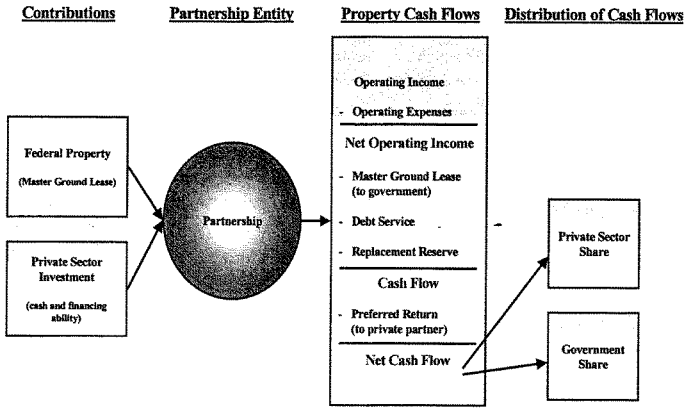
- ☑ Analyzed local real estate markets
  - Interviewed local industry professionals, reviewed industry reports and GSA records
  - Assessed market demand, absorption costs, new product pipeline, comparable rents, tenant finish costs, and construction costs
- ☑ Analyzed the properties' viability as public-private partnerships
  - Based on the project team's experience, interviews with industry professionals and interviews with other government agencies with public-private partnership authority
  - Assessed financial attractiveness, location, condition of the property, and the potential to serve private sector demand without guarantees from the public sector
- ☑ Analyzed the properties' economic feasibility as a public-private partnership
  - Used a cash flow model constructed for each property
  - Developed model assumptions using data gathered during the above analyses

I. Overview of Structure of Public-Private Partnerships for Real Property Management:

The U.S. Government is one of world's largest property owners, with a real estate portfolio of almost 435,000 buildings and over half a billion acres of land. Most of this real estate is under the control of 8 organizations: the United States Department of Agriculture ("USDA"), DoD, Department of Energy, Department of Interior, Department of Veterans

Affairs ("VA"), GSA, Tennessee Valley Authority (TVA), and United States Postal Service ("USPS"). To maximize returns on buildings and facilities, federal agencies are increasingly looking to partner with the private sector. These arrangements typically involve a government agency partnering with a private partner to renovate, construct, operate, maintain, and/or manage a facility or system, in whole or in part, that provides a public service.

Public-private partnerships can take many forms. One potential structure of a public-private partnership is:



II. Factors for Consideration of Potential Candidates for Public-Private Partnerships:

A. Criteria: Three central criteria can aid in evaluating a site for public-private partnership selection:

1. Government facilities and funding needs (e.g., viability given the sites' location and condition of the property)
2. Private sector investment potential (e.g., financial attractiveness)
3. Real estate market demand (e.g., potential to serve private sector demand without guarantees from the public sector).

B. Budget: In addition, because of the unique nature of the federal government's budget requirements, additional considerations include for public private-partnerships include:

1. Whether the partnership would augment a current lack of federal funds available for repair and maintenance of the property

2. Whether legislation impacting a specific property would have pay-as-you-go implications. For example, if the property is currently scheduled for sale/disposition in the GSA budget baseline, and legislation earmarks the property for partnership authority, any potential loss of receipts would trigger pay-as-you-go scoring to offset the lost revenues
3. Whether Office of Management and Budget ("OMB") guidance during implementation would trigger budgetary scoring consequences. For example, OMB requires that public-private partnership borrowings must be non-recourse to the government, and that leasing of these properties comply with OMB Circular A-11 capital/operating lease guidelines.

III. Benefits of Public-Private Partnerships for the Federal Government & Private Sector:

Public-private partnerships provide numerous benefits to both the federal government and the private sector. Some of the benefits can include:

☑ Government:

- Utilizes captive value of real estate in desirable sites
- Uses underutilized building, which may be a net cost to GSA, to a higher potential
- Efficiently improves facilities for federal tenants without direct federal expenditure
- Satisfies federal space (and local office) demands, which could save on leasing expenses
- Potentially serves other federal agencies currently in leased space
- Saves current costs to GSA to maintain the property
- Avoids capital expenditures in a functionally inefficient building
- Creates financial return for the government
- Protects public interest in and avoids disposition of historic properties
- Allows the federal government to benefit from private sector efficiencies.

☑ Private Sector:

- Unlocks value in previously unavailable real estate
- Creates return for the private sector
- Accelerates local redevelopment efforts
- Stimulates job market
- Enhances private sector customer service potential.

IV. Private Sector Considerations for Determining Public-Private Partnership Viability:

As noted above, factors for determining the viability of a property for a public private partnership include:

- ☑ Financial attractiveness – including the ability of the partnership to generate a sufficient return on investment
- ☑ Length of time for returns – this impacts financial attractiveness and is dependent on the term of ground lease or term of partnership entity
- ☑ Risk level of the investment – this depends on current and future market demand for the location and/or space
- ☑ Viability for potential multiple uses given the sites' location – which would enhance market demand for the site
- ☑ Condition and size of the property – this includes excess land on which additional buildings and uses could be created
- ☑ Potential to meet a private sector demand without guarantees from the public sector (e.g., the federal government does not guarantee financing or occupancy).

When completing analyses for individual partnerships, the federal government should perform in-depth reviews and further market research to better assess the total project internal rate of return as well as the proceeds for both the private partner and the federal government. In addition, it should assess the federal facilities demand and the non-federal market demand, as well as private sector investment potential, including the redevelopment strategy and master lease terms.

V. DoD and VA Enhanced-Use Lease Authority:

- Structure

1. *DoD*: The Department of Defense (DoD) owns over 284,000 buildings with over 1.8 billion square feet of space on over 23 million acres. Recently, the DoD authority for enhanced-use leasing under Section 2667 of Title 10 was expanded to permit installation commanders to retain up to 50% of new cash proceeds and all of the in-kind consideration received for a broader range of activities, including environmental restoration, new construction, and acquisition. This expanded authority extends to the entire installation.

   Leasing of property must promote the national defense or be in the public interest.

All lessees must provide consideration of not less than fair market value. And, leases are limited to five years, unless the Secretary determines otherwise.

2. *VA*: The Department of Veterans Affairs, which has a much smaller real estate portfolio than DoD, has had this authority for nearly a decade, and has used it to convert unused or underused property into single room occupancy shelters, two co-generation plants, office structures, and research facilities.

   The VA enhanced-use lease must support the mission of the Department, and enhance the use of the property. However, it can include both VA and non-VA uses. The lease term may not exceed 75 years. In lieu of cash, VA can receive facilities, services, and/or revenue as consideration. The VA formula is simple – leverage the real estate value to minimize the need for federal dollars and encourage uses that are valued by the private sector as well as the government.

- Different structures for public-private partnerships

DoD and VA enhanced-use leasing can take the form of a public-private partnership or a public-public partnership (e.g., DoD partnership with a local government agency). However, it does not include the authority to enter into limited partnerships, joint ventures, or trusts. The table below highlights some of the differences between the DoD, VA, and proposed legislation in HR 2710.

	DoD Enhanced Leasing Authority - §2667 – as Revised by the FY 2001 Defense Authorization Act	**VA Enhanced-Use Leasing**	**HR 2710 – Federal Asset Management Improvement Act of 2001**
Legislative Reference	U.S. Code Title 10, §2667, as amended (December 2000)	Title 38 §8161-8169, as amended (December 2000)	Introduced August 1, 2001 by Mr. Sessions and Mr. Davis
Real Estate – Conveyance/ Ground Lease Authority	• Lease land/facilities for cash or in-kind consideration • Permit use of land/facilities for in-kind consideration or cash • Base commander retains control of land/property leased	• Lease only	• Lease land/facilities for cash or in-kind consideration • Authority can be delegated by GSA to other agencies
Federal Investment/ Partnerships	• None, ground lease only	• None, ground lease only	• Lease, LLC, limited partnership interest, Corp, trust, other • Nongovernmental partner holds majority interest in ownership and profits
Federal Use of Cash Proceeds and Source of Funding	• Proceeds deposited in Special Treasury Account, spending subject to appropriation • Subject to appropriation, the Government may use at least 50 percent for authorized items such as facility maintenance and repair or environmental restoration;	• 75 percent deposited in the nursing home revolving fund • 25 percent credited to the Medical care • Note: VA has generally used in-kind consideration to date	• Proceeds deposited into fund created by section 210(f) of Federal Property and Administrative Services Act or general Fund of Treasury, subject to appropriation

	DoD Enhanced Leasing Authority - §2667 – as Revised by the FY 2001 Defense Authorization Act	VA Enhanced-Use Leasing	HR 2710 – Federal Asset Management Improvement Act of 2001
	construction/acquisition; lease of facilities; operations support at the site • Subject to appropriation, the remainder can be used at the base, or elsewhere within the service		• Appropriations required to spend cash proceeds
Lease Restrictions / Limits	• Secretary has authority to grant lease terms as appropriate (terms generally limited to 5 years, except where service Secretary deems longer lease is in public interest)	• Lease limited to 75 years • Must be compatible with mission of the VA	• Must enhance functional and economic efficiency of federal real property • Submit business plan to Congress before agreement

- Evaluating Alternatives

Each potential public-private partnership, and the tool used to participate, needs to be carefully evaluated on a case-by-case basis in order to determine which option offers the best economic value and mission enhancement for the government.

☑ Joint ventures where the government shares in a portion of the future project returns might be considered when:

- A property is determined by the government to be undervalued under current market conditions – and the government could then share in the appreciation in value of the site, or
- A property is considered high-risk by the private sector, thus requiring a higher return by the private sector – and the government could share in the higher return.

☑ A ground-lease with in-kind consideration might be considered when:

- The cash proceeds from a transaction are not available for retention by the agency, or
- The partner in the transaction brings special expertise or services through in-kind consideration that is considered by the agency to have a high value or create additional project or mission enhancement.

☑ Creation of a special purpose entity might be considered when:

- Shared space or space in close proximity would result in sharing of knowledge, which would enhance the federal mission, share resources with a hospital for lab space.

VI. Factors for Public-Private Partnership for the L. Mendel Rivers Federal Building in Charleston, S.C.:

Of the seven properties analyzed in this study, the L. Mendel Rivers Federal Building represented the strongest market location. The L. Mendel Rivers Federal Building is located in a prime and very desirable part of Charleston, in the heart of the Central Business District (CBD). From a market point of view, this property is in an "A+" location for office and hotel use. Currently, there is virtually no land available in the CBD for additional commercial development mainly due to its location on the peninsula. Consequently, the demand for new and additional office and hotel space is high. The surrounding neighborhood and existing neighboring land uses are attractive. Furthermore, the building itself is currently closed and unoccupied due to damage on the building from the last major hurricane. As a result, there are maintenance costs associated with holding the building in its damage condition. Although the property is a very attractive and desirable site, the preliminary market feasibility and cash flow analysis showed a moderate/ mediocre return for the project under office and hotel space redevelopment scenario.

VII. Considerations for GSA Use of Authority to Enter into Public-Private Partnerships:

There are a number of considerations that GSA will want to consider in using any new authority for public private partnerships. Some of the considerations include:

- ☑ Consistent Program Implementation
  - Ensuring consistent guidance is provided to the field offices and other agencies – this is particularly important in cases such as HR 2710, where the administrator can delegate the authority to other agencies
  - Issuing guidelines to properly identify potential sites
  - Developing standardized partnership proposal evaluation processes
- ☑ Property-Specific Market Research
  - Taking time to perform market research to identify the best target use and potential users of the property
  - Performing a feasibility study to determine the highest and best use for each asset based on market conditions, site condition, and true expected development costs (including remediation and other land use costs)
- ☑ Compliance with Federal Requirements
  - Determining if it is an historic property and thus subject to National Historic Property Act requirements
  - Determining if remediation is needed on the site subject to National Environmental Protection Act requirements
  - Conforming with OMB budget scoring rules and circulars

☑ Gauging, Attaining, and Monitoring of Private Sector Participation

- Attracting private partners through identification of properties that have high market appeal and sufficient return
- Ensuring that documentation and federal requirements are such that deals are eligible for private sector financing and securitization
- Bundling properties with the same developer for potential economies of scale
- Actively educating, informing, and marketing real estate opportunities to potential partners
- Working with partners to ensure internal controls and protection of federal interests in transaction.

Mr. TOM DAVIS OF VIRGINIA. Mr. Johnston, you're clean-up.

Mr. JOHNSTON. Good afternoon, Chairman Davis and members of the committee. My name is Sherwood Johnson III, president of the Building Owners and Managers Association International and a real estate professional with CarrAmerica. Thank you for the opportunity to address the issue of the Federal Government entering into public-private partnerships for real property.

First, let me start by telling you a little about BOMA. Founded in 1907, BOMA International is a dynamic federation of more than 100 local associations with over 18,000 members who own or manage over 8.5 billion square feet of commercial properties in North America. Our mission is to advance the performance of commercial real estate through advocacy, professional competency standards and research. The General Services Administration, along with other Federal agencies in State and local building departments are a valued segment of BOMA's membership.

Managers of public and private property alike face the constraints of tight budgets for funding repairs and alterations. However, owners and managers of private property have at their disposal a wide array of asset management and financing tools to assist them. It is our belief that the managers of government-owned buildings must be given similar tools and be allowed more flexibility.

To this end, BOMA International is pleased that the committee is considering legislation that would allow the GSA to enter into public-private partnerships. However, these public-private partnerships are just one of the many tools that the Federal Government property professionals should have at their disposal. We encourage you to go a step further and take into consideration all of the asset management tools that would allow the GSA and other agencies to do their jobs more effectively.

As Congress explores the opportunity to encourage public-private partnerships, it is critical to understand that the main thing the private sector will look for in any partnership is a return on invested capital. No one will enter into any arrangement with the government unless there is an expectation of economic benefit. So the primary question must be, how could the private sector make a return on any joint venture arrangement?

BOMA International generally supports the lease-back concept of public-private partnership arrangements. Here the government would have a private entity take over economic control of a building and renovate it. The government would have a first refusal option to lease the building back for a rent that includes a return on the building improvements.

Please keep in mind that absent the guarantee that the government would lease back the building, there would have to be a strong private sector demand for the space, based on location or physical attributes. The private developer would need a reasonable expectation that the building could be leased at a rate that would allow for the investments to be recouped.

This type of arrangement becomes much more problematic if the property is a special purpose building that did not have private sector demand. Separately, there might be some building that the gov-

ernment owns that would be profitable to lease outright to the public sector—excuse me, to the private sector.

In those cases, the government could lease to a private real estate company under a long-term lease. These companies would then invest in the repairs, lease the space to private sector companies and make money in the usual way. After the expiration of the lease, the building would revert to the government, who would inherit the improved property.

The benefits to all parties are obvious. A private sector company undertakes the management of the building, filling it with tenants for the benefit of both the private sector partner and the taxpayer. The government would retain ownership rights to a structure that it could bring back into its operational portfolio in enhanced condition. The risk of cost overruns is born by the private sector or could be shared with the Federal Government. As a result, the GSA would be better able to direct their scarce capital upgrade funds toward buildings that are not involved in the public-private partnership arrangements.

Finally, the private sector would appreciate having access to the public sector tenants who have previously not been part of the commercial real estate market.

While BOMA supports congressional action on this issue, we must once again caution that the GSA and the private sector will need flexibility in crafting these types of arrangements. Every building is different. Every real estate market is different. Every real estate transaction is different. The GSA and private sector partners must have the ability to enter into arrangements that are mutually beneficial; otherwise nothing will be accomplished.

BOMA International knows firsthand the GSA and other Federal agencies have highly educated and capable property professionals on their staffs. The Federal Government's property managers actively participate in BOMA's education and training opportunities. They hire top-notch people who are capable of using sound business and asset management principles to make educated decisions. I've personally had the pleasure of working with many of them.

While Congress has a role to play in overseeing this function of government, it will never be done effectively until the property professionals are allowed the flexibility to use all the tools available.

I thank the committee for its time. I would urge the committee to refer to BOMA's written comments, which are more extensive than my own testimony. BOMA International would welcome the opportunity to work with the committee and provide additional expertise as you proceed on these issues. And I'm also happy to answer any questions.

Mr. TOM DAVIS OF VIRGINIA. Thank you very much.

[The prepared statement of Mr. Johnston follows:]

Written Comments of the

Building Owners and Managers Association
(BOMA) International

Sherwood Johnston, III
President

Before the
House Committee on Government Reform
Subcommittee on Technology and Procurement Policy
The Honorable Tom Davis, Chair

Public-Private Partnerships

October 1, 2001

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The Building Owners and Managers Association (BOMA) International, the oldest and largest trade association representing the commercial real estate industry, is pleased to have the opportunity to address the issue of the federal government entering into public-private partnerships for real property.

Founded in 1907, BOMA International is a dynamic international federation of more than 100 local associations. Our 18,000 members own or manage over 8.5 billion square feet of downtown and suburban commercial properties and facilities in North America. The mission of BOMA International is to advance the performance of commercial real estate through advocacy, professional competency, standards and research. Our membership also includes managers of public buildings. The General Services Administration, along with other federal agencies and state and local building departments, are a valued segment of BOMA's membership.

We greatly appreciate the opportunity to discuss how the GSA and other federal agencies can effectively address the growing challenges created by aging and deteriorating federal buildings, and how BOMA International and our membership may assist the federal government in finding solutions.

Managers of public and private property alike face the constraints of tight budgets for funding repairs and alterations. However, owners and managers of private property have at their disposal a wide array of asset management and financing tools to assist them. It is our belief that the managers of government-owned buildings must be given similar tools and be allowed more flexibility.

To this end, BOMA International is pleased that the Committee is considering legislation that would allow the GSA to enter into public-private partnerships. However, these public-private partnerships are just one of many tools that the federal government's property professionals should have at their disposal. We encourage you to go a step further and take into consideration all of the asset management tools that would allow the GSA and other agencies to do their jobs more effectively.

For example, legislation should seek to enhance flexibility in all aspects of development and management, to include planning, acquisition, use, maintenance and disposal of real property assets. Subleases, transfer and exchanges of real property should be allowed in cases where it makes sound business sense and results in the agency receiving fair market value. Outright sales should also be considered viable alternatives. While the GSA has the ability to do some of this now, the federal government's scoring and budget constraints do not always allow the full range of options the GSA needs.

For example, the federal government tends to hold on to properties much longer than a for-profit company would. According to BOMA International's *Experience Exchange Report*, the average age of public buildings is 48 years, compared to 25 in the private sector.

In many cases, the GSA finds it necessary to renovate a building prior to its sale by conducting environmental remediation or needed site work. The cost of doing this would deplete their already limited funds appropriated for repairs and renovation. In addition, upon the ultimate sale of that property, proceeds would not be available for the GSA to use for other projects, but would revert back to the Land and Water Conservation Fund. The GSA would not be able to even recoup the money it invested in the property prior to its sale. The result is that these types of transactions are then pushed to the bottom of the priority list and the decision is made to hold on to the property even longer -- not based on sound business principles but, instead, on outdated budget rules.

In any situation where the federal government disposes of property or receives compensation on that property, this money should be available to provide additional space or renovate existing space. Any outright costs involved in these types of transactions should also be offset from the profit. This would allow the GSA to look at each need within the context of their entire portfolio.

As Congress explores the opportunity to encourage public-private partnerships, it is critical to understand the main thing the private sector will look for in any partnership is a return on invested capital. No one will enter into any arrangement with the government unless there is an expectation of economic benefit. So the primary question must be: "How could the private sector make a return on any joint venture arrangement?"

BOMA International generally supports the "leaseback" concept of a public-private partnership arrangement. Here the government would have a private entity take over economic control of a building and renovate it. The government would have a first-refusal option to lease the building back for a rent that includes a return on building improvements. Please keep in mind that, absent a guarantee that the government would lease back the building, there would have to be strong private sector demand for the space based on location or physical attributes. The private developer would need a reasonable expectation that the building could be leased at a rate that would allow for the investments to be recouped. This type of arrangement becomes much more problematic if the property is a special purpose building that did not have private sector demand.

Separately, there might be some buildings that the government owns that would be profitable to lease outright to the private sector. In those cases, the government could lease to private real estate companies under a long term ground lease. These companies would then invest in the repairs, lease the space to private sector companies, and make money in the usual way. After the expiration of the ground lease, the building would revert to the government, who would inherit the improved property.

The benefits to all parties are obvious: A private sector company undertakes the management of the building, filling it with tenants for the benefit of both the private sector partner and the taxpayer. The government would retain ownership rights to a structure that it could bring back into its operational portfolio, in enhanced condition, at the end of the lease. The risk of cost overruns is borne by the private sector or shared with the federal government. GSA would be better able to direct their scarce capital

upgrade funds towards buildings that are not involved in the public-private partnership arrangements. Finally, the private sector would appreciate having access to public sector tenants who have previously not been part of the commercial real estate market.

BOMA International supports Congressional action on this issue. However, we must once again caution that the GSA – and the private sector – will need flexibility in crafting these types of arrangements. Every building is different, every real estate market is different, and every real estate transaction is different. The GSA and private sector partners must have the ability to enter into arrangements that are mutually beneficial. Otherwise, nothing will be accomplished.

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BOMA International welcomes the opportunity to work with the committee and provide additional expertise on these issues. BOMA staff may be reached at (202) 326-6365.

Mr. TOM DAVIS OF VIRGINIA. I appreciate the questions from the panel.

Let me start with a question to BOMA and GSA, everyone. I wonder if you could elaborate a little bit on the potential budget effects of these partnerships in the bill at hand, H.R. 2710. And what are the specific scoring triggers that could bar successful implementation of the public-private partnerships? Who wants to start on that?

Mr. JOHNSTON. Well, the GSA is probably the most qualified to answer the question about the scoring issues that they have.

Mr. TOM DAVIS OF VIRGINIA. All right.

Mr. PERRY. Let me begin on that, and I'll invite my colleague, Joe Moravec, to maybe respond as well.

But specifically, with respect to scoring, it really relates to the last part of Mr. Johnston's testimony. Since these will not be one-size-fits-all kinds of transactions, there will be the need to consider each transaction separately. The scoring rules need to have consistency.

We believe, as we have looked at a number of projects which may well fit under this public-private partnership approach, that the scoring rulings, as they are currently interpreted and used, would result in our being able to go forward with those kinds of projects. We are working closely with OMB with respect to this to make sure that is the case.

Joe, would you care to elaborate?

Mr. MORAVEC. The specific things that would score, that would cause a scoring convention to be violated, would be if the government were, in fact, leasing back from itself.

The way this H.R. 2710 has been written is that the government would not guarantee a lease-back. In other words, the lease-back of the space by a government agency would be separate and apart from the creation of the public-private partnership, so that the public entity leasing back would be, in effect, an arm's-length lessee of the property.

Second, the way the legislation is crafted, there would be no subordination of the government interests. The government would have an unsubordinated senior interest in the property and it could never, in effect, be foreclosed on, so that its actual equity in the property and the partnership would never be at risk.

And finally, the way the legislation is crafted, there would be—the government's liability in the partnership would be no greater than the value of the equity that it's contributed. So the government would have no indebtedness.

And as Administrator Perry has said, as long as those three conditions are present in the creation of a public-private partnership, we believe that we will be well within scoring conventions.

Mr. TOM DAVIS OF VIRGINIA. So this legislation suffices, you think? It doesn't need to be tweaked any?

Mr. MORAVEC. We do.

Mr. TOM DAVIS OF VIRGINIA. OK. Thanks.

Let me ask GAO, if the administrator of GSA is given the authority to proceed with the public-private partnership program, what controls, both internal to GSA and external, do you think should be in place to ensure proper management of the property?

Mr. UNGAR. Mr. Chairman, I think there are a number. First of all, I think it would be appropriate for GSA to have a real good, solid business plan which lays out the business case and the financial issues, the risks, who's going to assume those risks and how the project would, you know, be operated.

Second, GSA, in our view, would come up—or, you know, would be wise to come up—with some criteria that it would use in terms of deciding whether to go forward or not, what factors, what conditions ought to be present or should not be there in order to proceed on a public-private partnership.

Third, we think there ought to be some sort of review and approval process that is systematic within GSA to make sure all the bases are covered, the i's dotted, t's crossed. That would include some form of congressional notification of the intent to proceed, as well as probably some effort to work with the local community involved to assure that there aren't any pitfalls or unforeseen issues there.

And finally, some sort of an evaluation process that would be—a plan and process that would lay out how GSA intends to measure the success of the effort once it gets going.

In addition to that, we would suggest that Congress also certainly review the proposal of the relevant committees, the subcommittees, as they currently do for large projects that GSA proposes, and that there would be some congressional oversight of the process and, particularly, the use of funds that would be retained as a result of these projects.

Mr. TOM DAVIS OF VIRGINIA. Thank you.

Let me ask Mr.——

Mr. PERRY. Mr. Chairman, may I just quickly elaborate on Mr. Ungar's response?

First of all, I'd just like to say that we fully agree with every single point he made, and in the proposal that we have submitted, each of those points is addressed, starting with the strategic plan to the overall process, to the review and approval, including review by Congress, the evaluation is there, as well as making a final review to renew the legislation after a 10-year sunset.

Mr. TOM DAVIS OF VIRGINIA. OK.

Let me ask Ernst & Young, Ms. Burke, do you know any examples of private-public partnerships at the State or local government level that could be used as a guide in crafting a workable program here at the national level?

Ms. BURKE. We do. One example is Penn Station in New York. Another example is the Seventh Regiment Armory in New York. Another example is Arizona State University.

A lot of the construction State and local governments have done, and cities of athletic facilities, like stadiums, take the form of partnerships that are very similar to this. And so those would be examples.

Mr. TOM DAVIS OF VIRGINIA. I think there is tremendous potential. This allows private businesses to do this kind of thing every day. They do it because it is in their financial advantage to do it.

Let me ask any—my minutes are up.

Mr. Turner.

Mr. TURNER. Thank you, Mr. Chairman.

Mr. Perry, the proposal that you have been referring to I understand is being reviewed by OMB currently for their comments.

Mr. PERRY. Yes, sir. That's correct.

Mr. TURNER. What are the areas of concern that have arisen out of that review, or have you yet to hear regarding what their view is on this proposal?

Mr. PERRY. We have heard what their view is on the proposal. We are in lock-step agreement with respect to the proposal. We have worked very closely with Shawn O'Keefe and others on his staff to discuss the objectives. And the legislation has been circulated among the other agencies to get feedback for the proposed legislation.

And to my knowledge there was nothing adverse that has come. So my understanding would be that we are in agreement with respect to the objective of this legislation.

Mr. TURNER. But they are also looking at the actual bill itself that you had last year with regard to the specific details of it; is that correct?

Mr. PERRY. All of that was a part of the input; that is, where we were last year at the end of that session of Congress was a starting point. We recognized that there were shortcomings in last year's proposal, and so we worked on eliminating these items that would have been items that could have rendered the use of last year's bill to be fairly difficult, and we have gotten those things to be addressed, partly by, as was mentioned, the strategic plan and the process that we have outlined.

Mr. TURNER. This suggestion, I believe, that was in the bill, that if the value of the property is not over $2 million, then there is no congressional review, as I understand that process, it is just basically a notification to basically the staff of this committee that a sale is proposed. Currently I guess it is any sale over $100,000; is that correct?

Mr. PERRY. I think that is the correct number. We haven't worked out the details of that, but the objective of this is—that is to say, if there is a project under consideration that has a value of $2 million or more, that we would effectively notify the Congress, not just something that would be perfunctory, but effectively inform the Congress what our intentions were before moving ahead.

Mr. TURNER. Under the current process for congressional oversight, if you have notified the Congress, and this committee has reviewed it and doesn't approve of it, does this committee or this Congress have any control over that decision, or it is merely a notification process that we are talking about here?

Mr. PERRY. I am going to ask Joe to respond to that. My belief is that we would adhere to the direction that we get from congressional moods on this. It is done through the budget process where we name the specific project that is under consideration and get budget authority for it.

Mr. MORAVEC. Right now it is—prospective level for projects that require congressional authorization is about $2 million. So this is totally consistent with the process that we subscribe to now with regard to all of our capital investment submissions to Congress.

Mr. TURNER. But as I understood it, we—there is a provision that talks about a $100,000 value and above, and does that relate to disposal of property? Is that what that relates to?

Mr. MORAVEC. That is related to disposal.

Mr. TURNER. Is there a proposal in this legislation to change that as well?

Mr. PERRY. Yes. That is in the section having to deal with streamlining the disposal process. Yes.

Mr. TURNER. All right. Now, if I understood that provision, if the Congress is notified that a piece of property worth $150,000 is going to be sold, and this committee reviews that and has some objection, is there any procedure where we actually have any role of changing your mind, or is that simply a notification procedure?

Mr. MORAVEC. I think as a practical matter we wouldn't move until we had resolved that with the committee.

Mr. TURNER. Even though there is no statutory authority in the Congress to block the sale of a property at that level?

Mr. MORAVEC. Even though there is no statutory authority.

Mr. TURNER. Has that been particularly burdensome to give such notice to this committee regarding disposal of property in excess of $100,000?

Mr. MORAVEC. It is not particularly burdensome, it is just that the dollar threshold, we believe, is a little low. We would like a little more latitude in terms of the dollar amount involved.

Mr. TURNER. But I mean as a practical matter, does it really represent any significant impediment to the process of disposal just to notify this committee that the properties——

Mr. PERRY. It would be a case of—we haven't encountered any difficulty with respect to those items. Many of the properties that we do dispose of are in excess of that previous limit. We think it is a matter of administrative efficiency to not send that many requests over.

As it turns out, there hasn't been a burden. It is more of a case of low value kind of work, both on the part of GSA and on the part of the Congress, to review them.

Mr. TURNER. How many times would this committee ever see notice, say over the last year, that property was going to be disposed of?

Mr. MORAVEC. I am sorry. We will have to get back to you for the record on that.

Mr. TURNER. I want—I only make the inquiry—it strikes me if this is just a notification procedure, and it is not too extremely burdensome, then it is probably a good thing for the Congress to know; particularly if it involves a piece of property in, you know, my district, I would like to know.

And I don't have much in my district that you could dispose of that would be over $2 million, so it might be a provision that would be nice to keep in the law, at least as some lower limit than $2 million.

That is all the questions I have.

Mr. TOM DAVIS OF VIRGINIA. Thank you.

Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman. This is a very worthwhile hearing. And it does have effects across the country. And I am glad

to see the Administrator of GSA here, Mr. Perry. I hope will you enjoy the way we do business. You had a fine record in Ohio.

And I would like to ask a question about Deputy Under Secretary DuBois. How long has the environmental portion of your rank—was that earlier in the Office of the Secretary of Defense, but not with the Under Secretary, or Deputy Under Secretary? When did that move?

Mr. DUBOIS. Under the prior administration, the Clinton administration, there was established the Deputy Under Secretary of Defense for Environmental Security, I believe, in 1993.

When Mr. Rumsfeld became Secretary and was confirmed on January 20th, we discussed various ways to streamline the management and the procedures of the Office of the Secretary of Defense.

It was considered a good idea at that time, and I think it continues to be a good idea, to combine both installations and environment, because one impacted the other in both positive and negative ways, as you well know, given the hearing that you held in California, sir. Therefore, on April 29th, when I was appointed to this position as Deputy Under Secretary for Installations and Environment, it so was established.

Mr. HORN. I think that makes a lot of sense, personally, and I had been griped the other way that this—it never was going anywhere in 1994, 1995. They just sort of sat on the money was my feeling.

And in my Subcommittee on Government Efficiency we took a hearing a few weeks ago at Fort Ord, and that is—we appreciate the help that is there from a lot of you there. But we have a little problem still there, which is live artillery. And there has been, I think, the one heavily hospitalized, and I am told one died there. And I just would like to see if we can help on that, because that was under the Army to put the money out.

And another one I am going to take here was from the Navy. And I think you are absolutely right to have that under the Office of the Secretary with somebody with some clout, and you are the one with clout I am looking at.

So let me go down the line on a few questions I want to have Administrator Perry—I am sorry, I came in late because I had the usual 15 people in our office.

What is the length on the contract that GSA feels on land use? Have you picked a number? Is it 20? Is it 25? 30? 50? What?

Mr. PERRY. The proposed legislation would allow as long as 50 years for that. We would expect that the individual leases would be of a shorter term, but 50 is a general maximum.

Mr. HORN. Well, I am glad to see that, because some end at 5 years, 10 years, 20, just wasn't working.

Mr. PERRY. Right.

Mr. HORN. In our case I want to thank you for the GSA working with NASA in the town of Downey. Now, that was the Rockwell plant that built the space lab, the Apollo, the one that now sends it up and back, that one, but Boeing now takes that over. And it was already going because we couldn't keep the repairs going since it was just—they were not needed at that point.

So in Downey you have got a plant that, when I came to that area in 1970 that had 35,000 workers, now have none. I don't think there is even a maintenance person to keep that property, because it is a patch system where the old committee on—at Goddard was on way back in the 1930's. And the—obviously NASA is now in it, and Administrator Goldin has been very helpful, and we appreciate that.

And so that is another one there that I would hope it has worked out, and I think it is supposed to be worked out, Mr. Perry, because there is a lot of other agencies, EPA, so forth, besides GSA, and we would appreciate it if we could just finish that one up.

Now, another one is on the west side of Long Beach. In the 1930's, Long Beach was the headquarters of the Pacific Fleet. And one chief executive of the—Chief Operating Officer of the Navy, he said that was the stupidest decision that they ever had was to go to Hawaii. You saw what happened. By accident we had our aircraft, people out there, but thousands died December 7th. And on that land on the west side, it was naval housing for about 38 ships. That was under my predecessor Mr. Anderson.

What we turned that into is something that gets economic development, and one—there is three things here. We have a technical high school being built. I was able to get out of the President a Job Corps situation back in about 1995. And then there is—besides the Job Corps, the technical high school. We had there 30 acres for the College of Engineering at California State University Long Beach. That is very needed because Orange County has now had a good Silicon Valley-type approach, just like Fairfax County and San Diego, but southern Los Angeles County have not had the development that they should have. And, of course, the land that went to the Port of Long Beach is very helpful. But we could do better in terms of biological and Silicon Valley-type firms.

Then we have on the east side of town, which is coming along, there were two patches there given to the Navy, $1 apiece, in the beginning of the Second World War. And that—unfortunately the city attorney missed one, and they gave them the dollar and thought, well, if they ever leave, they will give us the property back.

And the fact was that they went—when the split came, where the city attorney had put that in, we easily got that property to revert back to the city of Long Beach. And they are still in a situation, or were with the Navy, of, well, you owe us $8 million. Good heavens, you know, that is a pretty good property for the dollar that we asked them to give us back in the—oh, probably 15 years ago that they closed that naval hospital, which was about 5,000 people with patients and all of that.

So those are the examples I have lived with in a way, and I would appreciate it if we could take a look at that, and I would like to sit down with you, Mr. DuBois, and see if we can't work it out and finish it forever and get the economic side of that part of Los Angeles County—it would be very helpful.

So I thank you all for your testimony. And, as I said, Fort Ord it is coming along. It has got a wonderful campus of the California State University system at Monterey Bay. They had 5,000 applicants the first year they opened there. And there is space there for

economic development, more of it, and we appreciate anything you can do on that. Thank you.

Mr. TOM DAVIS OF VIRGINIA. Thank you very much. I didn't mind it, I did my basic training at Fort Ord 100 years ago.

Mr. HORN. No fooling. Well, you should have come up and seen me. I was at Fort Ord, too, in terms of shooting off rifles, but I didn't shoot off the artillery.

Mr. TOM DAVIS OF VIRGINIA. It is amazing what they have done with that. When I was driving through recently, I dropped by to see some of the construction that they have had.

Let me ask a few more questions before we wind this up.

I will start, Mr. Perry, with you. What are the major barriers to effective asset management that you see right now at the Federal level?

Mr. PERRY. Well, there are a number of major things. First of all, there is not at this point in time a—sort of a global standard as to what the process should be for what we call life cycle management, not only to apply good practices in the case of acquisition, but to also apply good property management practices throughout the asset's life and to apply good processes to its subsequent disposal.

So those are among them. There are some other things that you might cite among those, that is—for example, making sure that agency acquisition and use of real property assets are consistent with the agency's mission. Now, some of that would sound pretty straightforward. You know, you decide whether you need the asset for a long term, in which case owning it might make sense, or is it a short-term need, in which case leasing would make much more sense.

We don't think that all of the agencies have people on their staffs who are skilled at thinking through those. What we would propose to do, therefore, is to provide this list of management principles and standards that we would help to ensure that each agency follows.

Mr. TOM DAVIS OF VIRGINIA. Do you have any idea how many pieces of property GSA owns right now that aren't being utilized, for one reason or another, and are either boarded up and are just sitting there?

Mr. PERRY. We don't know how many complete facilities would fall in that category. I do know that we have over 100 buildings that we have documented that have what we have called egregious conditions with respect to the need for upkeep. Many of those buildings are nevertheless still occupied, or at least partially occupied. We do have some where Federal agencies have moved out and refused to use the space based upon condition.

But there is this 100 or so that are in a deteriorated state, and then within that group of 100 we have identified 20 that would be sort of on the top list that need immediate attention.

Mr. TOM DAVIS OF VIRGINIA. OK, let me ask you another question. What would be the benefit of broader legislation? Are you familiar with S. 2805 introduced by Senators Thompson, Lieberman?

Mr. PERRY. Yes.

Mr. TOM DAVIS OF VIRGINIA. How would the provisions of this bill enhance the management of Federal property; how would that be effective for you?

Mr. PERRY. Well, first of all, it—that bill would have had some limited or some restrictions on the use of the public-private partnership approach, and we would propose that those limitations be eliminated.

Additionally, the bill may not have addressed the issue of disposal. I think it did address disposal, maybe not as comprehensively as we are. It did include both the use of outleasing and subleasing, which, by the way, are not as comprehensive in the Sessions bill.

So when you take those bills together, I think it generates a package. As long as you take the best of both, that would make it workable.

Mr. TOM DAVIS OF VIRGINIA. OK, let me ask the representatives from DOD and VA, what are the cost savings to the government that you have demonstrated through the use of public-private partnerships?

Mr. DUBOIS. As you know, in the Department of Defense military housing privatization alone has probably saved, will through the end of this fiscal year, that is to say 2002, probably—and "savings," again, is a difficult term. Leveragewise we may be dealing with nearly $1 billion.

You asked a few minutes ago about asset management, what would help us manage our assets better. Clearly until the Defense Department—and I think, no question, we concur in GSA's proposal, which is, as we read it, more far-reaching than the Sessions bill, those authorities given to us ought to be given elsewhere in the Federal Government, utility privatization and enhanced use of leasing, military housing privatization.

But the most important asset management authority that Congress could give us at this time is for a further round of base closures and realignment, which we hope will come out of the conference. As you know, the Senate did vote essentially for it last week 53 to 47. That in and of itself could save the Department of Defense, i.e., the American taxpayer, anywhere from $3 to $6 billion more.

Mr. TOM DAVIS OF VIRGINIA. I am in support of that. I mean, Mr. Turner is on the committee in the House. It is very controversial with a lot of the districts that would be impacted from that, but I agree with you.

Mr. KUSHNIR. From the Department of Veterans Affairs perspective, we saved a considerable amount of money. I think I mentioned in my testimony, we have achieved over $250 million worth of value that was invested into VA properties. This included energy plants, and it included parking facilities, medical facilities, and also resulted in significant savings to VA operational dollars, which are really paid out of its medical care funds. So it results in more of those funds directly being used for veterans' health care.

So we have found this enhanced use leasing, which is essentially a public-private partnership vehicle, as being very helpful to us in achieving our mission requirements.

Mr. TOM DAVIS OF VIRGINIA. I think sometimes we just pass too many rules and regulations that centrally drive things that we try to keep open, public, and keep people from stealing money, but we don't allow you to do a lot of other things, too, in the process.

We ought to let you manage this and give you the tools. And we see this done every day in the private sector where they are driven by a bottom line. I just think it makes everything more efficient. I think you agree as well.

Mr. KUSHNIR. Yes, sir.

There was a question earlier, comments about stakeholder involvement. Our legislation provides for public hearings at the site where we are contemplating doing an enhanced use lease, and our enhanced use leasing goes from a sort of a lease, lease-back arrangement, to more of your outlease arrangement that was talked about earlier in deriving revenues from it.

But we believe in public hearings. We also have congressional notification to our oversight committees for each and every one of our proposed enhanced use leases.

Mr. TOM DAVIS OF VIRGINIA. Thank you.

Anyone have anything else that they want to add?

Mr. PERRY. Yes, Mr. Chairman. I think what we are really looking at here is a decision to decide to apply what I would call very prudent good management practices. And as I have listened to today's testimony and the other information that I have been able to be a part of as we have worked on this project, it would appear to me that the evidence is pretty conclusive that this prudent good management practice is tried and tested and proven in the commercial sector. And we heard that again today from Ms. Burke of Ernst & Young, and from. Mr. Johnston on BOMA.

I think we are very fortunate to have Joe Moravec as our Commissioner of Public Service, having done this himself personally for 30 years. So we are not speculating with respect to whether this is something that can work.

Second, we also heard from representatives of DOD and VA that this, in fact, even works in the public sector, has been working in terms of the demonstration projects. And then we have had the General Accounting Office do a thorough review and also endorse the fact that this can work.

So I hope there is no further concern as to whether or not we are embarking upon something which is not tried and tested.

The other issue is we have, as we sit here, a large and growing inventory of deteriorating Federal buildings, not a livable situation. There is—on my way of looking at it—no other alternative solution on the horizon. And each day we wait, each year we wait, and we have waited a year since this was introduced in the last session, that inventory and backlog of repair and alterations work which is continuing to grow does grow.

So I commend the committee for taking a serious look at this so that we don't leave a legacy of further deteriorated Federal buildings, and, in fact, we take the bold step to be the group that provides the answer to the problem that we have been living with for a number of years now.

Mr. TOM DAVIS OF VIRGINIA. Thank you very much. I want to thank all of you, for attending the hearing. We have had some great testimonies today.

I want to thank Congressman Turner, Representative Horn and Representative Sessions for participating.

I want to thank my staff and Mr. Turner's staff for organizing this. I think it has been very, very productive. I'm going to enter into the record the briefing memo distributed to subcommittee members.

We will hold the record open for 2 weeks from this date for those who may wish to forward submissions for possible inclusion.

These proceedings are closed. Thank you.

[Whereupon, at 5:10 p.m., the subcommittee was adjourned.]

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