



June 16, 2016

The Honorable Ander Crenshaw
Chairman
Subcommittee on Financial Services and General Government
Committee on Appropriations
House of Representatives

Federal Real Property: Observations on GSA’s Canceled Swap Exchange Involving Buildings in the Federal Triangle South Area

Dear Mr. Chairman:

The General Services Administration (GSA), which manages federal real property on behalf of other federal agencies, continues to face challenges replacing, maintaining, and disposing of aging federal properties due to budget constraints and other reasons we have identified in our previous real property work.¹ According to GSA officials, funding has not kept pace with GSA’s need to replace and maintain the approximately 1,500 buildings in its federal real property portfolio. The prescribed process for the disposal of federal properties that are reported as excess by federal agencies can take years to complete.² Using various available legal authorities, GSA has begun to exchange title to federally owned real property for other properties or construction services.³ One type of transaction, called a “swap-construct” exchange (or swap exchange), enables GSA to apply the value of federal property to finance construction needs without relying on appropriated funds. Under such an exchange, after receiving the constructed asset or upon completion of construction services at a different location, GSA transfers the title of the federal property to the private investor that provided the construction services. Swap exchanges can be of equal value or can include cash to compensate for a difference in value between the federal property and the asset or services to be received by the federal government. GSA can

¹ We have previously reported that historically, the Federal Buildings Fund, which serves as GSA’s primary source of funding for operating and capital costs associated with federal real property, has been challenged to provide sufficient revenue to support GSA’s real property portfolio. Congress exercises control over the Federal Buildings Fund through the appropriations process that sets annual limits—called obligational authority—on how much can be obligated for various activities. See 40 U.S.C. § 592. In recent years, budgeting and appropriations decisions made by the executive branch and Congress, respectively, have reduced the amount of resources made available to GSA to fund its real property operations. Also, the federal government’s real property holdings continue to remain a long-standing high-risk level issue. See GAO, *Federal Buildings Fund: Improved Transparency and Long-term Plan Needed to Clarify Capital Funding Priorities*, [GAO-12-646](#) (Washington, D.C.: August 2012). GAO, *Capital Financing: Alternative Approaches to Budgeting for Federal Real Property*, [GAO-14-239](#) (Washington, D.C.: March 2014), and pp. 135-141 of GAO, *High-Risk Series: An Update*, [GAO-15-290](#) (Washington, D.C.: Feb. 11, 2015).

² In the prescribed disposal process, excess real property is first offered to other federal agencies. If no federal interest exists, then the property is screened for possible homeless housing use. If the property is judged unsuitable for homeless housing use or if there is no successful application for homeless housing use or any other applicable public benefit conveyance, then the property is offered for public sale.

³ See 40 U.S.C. § 3304(a); 40 U.S.C. § 3305(a)(1); 40 U.S.C. § 3305(a)(2); 40 U.S.C. § 581(c)(1); 40 U.S.C. § 543; Consolidated Appropriations Act of 2005, Pub. L. No. 108-447, § 412, 118 Stat. 2809 (2004).

use the value of property for its real property needs and any remaining proceeds from GSA properties may be credited to the Federal Buildings Fund.⁴

However, GSA's experience in using swap exchanges is limited. We previously reported on two small (under \$10-million each) swap exchanges completed in Atlanta, Georgia, and San Antonio, Texas.⁵ GSA officials told us that in their opinion, both exchanges were a good value for the government because the properties and construction services received were of equal or greater value than the federal properties disposed of in the exchanges. From 2012 to 2015, GSA pursued a larger swap exchange potentially involving multiple federal properties located in one area of Washington, D.C., known as the Federal Triangle South project (the Project). On February 18, 2016, GSA decided to end its pursuit of the Project. GSA canceled the Project, including its solicitation to exchange two buildings—the GSA Regional Office Building (ROB) and the Cotton Annex—for construction services at its headquarters, saying in a memorandum about this decision that private investor valuations for these two buildings fell short of the government's estimated values.

Prior to the Project's cancellation, you asked us to examine the plans for and risk associated with the Project. Taking the cancellation into account, this report addresses: (1) how GSA's plans for the Federal Triangle South project changed from 2012 to 2015 and why these changes occurred, and (2) factors that contributed to GSA's 2016 determination that the Federal Triangle South project was not financially viable and any lessons GSA learned from its experience with the canceled project.

To examine how and why the plans for the Project changed and the factors that contributed to GSA's canceling the Project, we reviewed GSA's plans for the Project since its inception in 2012. We also reviewed written responses that GSA received from both its request for information (RFI) and request for proposal (RFP) relating to the Project to understand respondents' plans and interests, if any, in the swap exchange.⁶ To further determine the factors that contributed to the cancellation, we reviewed the 2016 decision memorandum discussing the reasons why GSA canceled the Project.

After obtaining the estimated costs for construction services at GSA headquarters, we conducted a comparative analysis between appraisals of the GSA's ROB and the Department of Agriculture's Cotton Annex prepared by certified appraisers for GSA in 2015 and valuations contained in the proposals submitted to GSA by private investors. We do not report the estimated construction costs, the actual appraisal amounts, or the specific valuations contained in the proposals because GSA considers these figures sensitive information and believes that the public release of these figures could negatively affect future negotiations with potential investors in these properties. We also reviewed GSA correspondence with various federal and local stakeholders regarding the Project and interviewed officials from the National Capital Planning Commission and the District of Columbia's Historic Preservation Office to obtain their views about the Project. Finally, we interviewed GSA officials about the agency's overall

⁴ See Consolidated Appropriations Act of 2005, Pub. L. No. 108-447, § 412, 118 Stat. 2809, 3259 (2004).

⁵ See GAO, Federal Real Property: GSA Should Better Target Its Use of Swap-Construct Exchanges, [GAO-14-586](#), (Washington, D.C.: July 2014).

⁶ An RFI may be used when the government does not presently intend to award a contract, but wants to obtain price, delivery, other market information, or capabilities for planning purposes. See FAR § 15.201(e). RFPs are used in negotiated acquisitions to communicate government requirements to prospective contractors and to solicit proposals. See FAR § 15.201.

approach to the swap exchange process and any lessons learned from the cancellation of this swap exchange project.

We conducted this performance audit from November 2015 to June 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results in Brief

In 2012, GSA began exploring a project to exchange up to five office buildings located in the Federal Triangle South area of Washington, D.C. to finance construction services at GSA headquarters and other federal properties. Informed by the responses from private real-estate investors about their interests in a swap exchange in the Federal Triangle South area, GSA in 2013 decided to focus on exchanging two buildings—the GSA ROB and the Cotton Annex—in order to reduce some risks associated with the Project and facilitate a more manageable swap exchange. For example, five of nine RFI respondents noted the complexities of exchanging all five buildings in one project and one respondent suggested that GSA divide the Project into a series of smaller transactions.

After evaluating proposals from three qualified investors submitted in late 2015, GSA canceled the Project and concluded in its February 18, 2016 memorandum on this decision that private investor valuations for these two buildings fell short of the government's estimated value. We independently analyzed proposals and found that qualified investors proposed values for the GSA ROB and the Cotton Annex that were substantially less than those contained in an independent appraisal that GSA had obtained. These differences were due, in part, to the assumptions and methodologies used to make the GSA and investors' valuations. According to GSA officials, their experience with the canceled Project will help guide future efforts. For example, GSA officials said that they intend to improve the appraisal process for buildings involved in swap exchanges by (a) informing appraisers of the swap exchange's goals, objectives, and processes; (b) allowing appraisers to consider a range of values for uncertainties related to zoning and other economic assumptions; and (c) encouraging appraisers, when appropriate, to develop methodologies that take into consideration the size and complexity of proposed swap exchanges.

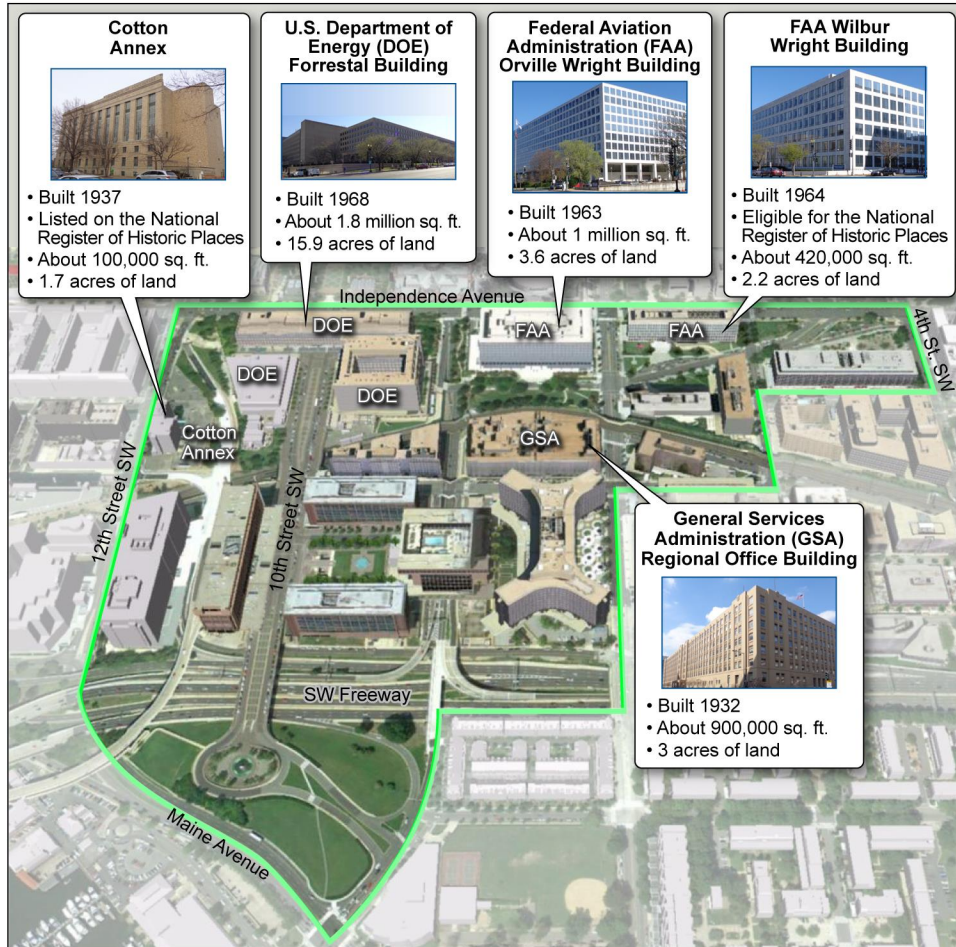
GSA Initially Considered Exchanging Up to Five Federal Properties for Construction Services, but Subsequently Focused on Two Properties to Mitigate Some Risk

Initial Plans Explored Exchanging Up to Five Buildings for Construction Services at GSA Headquarters and Other Federal Properties

In 2012, GSA began exploring a potential swap exchange of five office buildings in the Federal Triangle South area for construction services at its headquarters and other federal properties. According to GSA, these five buildings, all built prior to 1970, are challenged by high operating costs, a backlog of required capital improvements, land and office space inefficiencies, and a lack of area amenities. As shown in Figure 1, the swap exchange included the Department of

Agriculture’s Cotton Annex, the Department of Energy’s Forrestal Building, the Federal Aviation Administration’s Orville and Wilbur Wright Buildings, and the GSA’s ROB.

Figure 1: Location and Description of Federal Triangle South Properties in Washington, D.C.



Sources: National Capital Planning Commission and GAO. | GAO-16-571R

Accessible Text for Figure 1: Location and Description of Federal Triangle South Properties in Washington, D.C.

Cotton Annex

- Built 1937
- Listed on the National Register of Historic Places
- About 100,000 sq. ft.
- 1.7 acres of land

U.S. Department of Energy (DOE) Forrestal Building

- Built 1968
- About 1.8 million sq. ft.
- 15.9 acres of land

Federal Aviation Administration (FAA) Orville Wright Building

- Built 1963
- About 1 million sq. ft.
- 3.6 acres of land

FAA Wilbur Wright Building

- Built 1964
- Eligible for the National Register of Historic Places
- About 420,000 sq. ft.
- 2.2 acres of land

General Services Administration (GSA) Regional Office Building

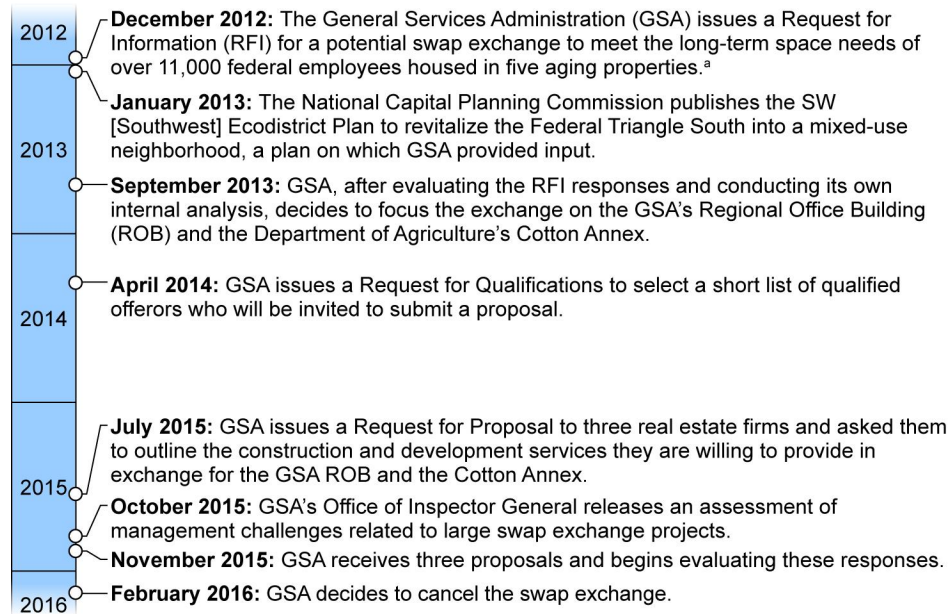
- Built 1932
- About 900,000 sq. ft.
- 3 acres of land

Through this swap exchange, GSA aimed to transfer these underperforming assets out of federal ownership in order to reduce the federal footprint and support the June 10, 2010 presidential memorandum, *Disposing of Unneeded Federal Real Estate*. GSA also sought to leverage the value of these five buildings to provide more efficient and sustainable office space for over 11,000 federal employees, and to obtain the best value for these properties to modernize other federal properties without requiring appropriations from the Federal Buildings Fund. Furthermore, GSA officials said that the Project could help revitalize the greater Federal Triangle South area, to the extent possible, using aspects of the National Capital Planning Commission's SW [Southwest] Ecodistrict Plan.⁷ The Planning Commission's plan, developed in collaboration with GSA and other federal and local agencies, lays out a strategic vision to transform Federal Triangle South into a walkable neighborhood with a mix of residential and commercial buildings.

About the same time as the release of the Planning Commission's plan, GSA officials said that they began exploring the possibility of using GSA's exchange authorities to finance construction services for its headquarters modernization. GSA had used funds from the American Recovery and Reinvestment Act of 2009 to complete Phase 1 of its two-phase, headquarters modernization. However, to complete Phase 2, GSA officials said that they faced challenges in obtaining sufficient appropriated funds. As a result, GSA officials sought to measure market interest in the five buildings identified as potential candidates for the swap exchange through an RFI released in December 2012. Figure 2 shows the chronology of key events that followed.

⁷ National Capital Planning Commission: *The SW Ecodistrict, A VISION PLAN FOR A MORE SUSTAINABLE FUTURE* (January 2013).

Figure 2: Chronology of Key Events Related to the Federal Triangle South Project



Source: GAO analysis of General Services Administration (GSA) information. | GAO-16-571R

^a A swap exchange enables GSA to apply the value of federal property to finance construction needs without relying on appropriated funds.

Accessible Text for Figure 2: Chronology of Key Events Related to the Federal Triangle South Project

December 2012: The General Services Administration (GSA) issues a Request for Information (RFI) for a potential swap exchange to meet the long-term space needs of over 11,000 federal employees housed in five aging properties.^a

January 2013: The National Capital Planning Commission publishes the SW [Southwest] Ecodistrict Plan to revitalize the Federal Triangle South into a mixed-use neighborhood, a plan on which GSA provided input.

September 2013: GSA, after evaluating the RFI responses and conducting its own internal analysis, decides to focus the exchange on the GSA's Regional Office Building (ROB) and the Department of Agriculture's Cotton Annex.

April 2014: GSA issues a Request for Qualifications to select a short list of qualified offerors who will be invited to submit a proposal.

July 2015: GSA issues a Request for Proposal to three real estate firms and asked them to outline the construction and development services they are willing to provide in exchange for the GSA ROB and the Cotton Annex.

October 2015: GSA's Office of Inspector General releases an assessment of management challenges related to large swap exchange projects.

November 2015: GSA receives three proposals and begins evaluating these responses.

February 2016: GSA decides to cancel the swap exchange.

Based on Responses to the Request for Information, GSA Focused Its Efforts on Two Buildings to Mitigate Some Risks

Informed by responses to the RFI and to help mitigate some of the risks of a swap exchange, GSA decided in September 2013 to reduce the number of properties from five to two—the GSA ROB and the Cotton Annex—to be exchanged for construction services at GSA's headquarters

and at up to four historical buildings at the planned Department of Homeland Security headquarters at the former St. Elizabeth Hospital's campus in Washington, D.C.⁸ According to GSA officials, the focus on two buildings was intended to facilitate a more manageable swap exchange. More specifically, based on the responses to the RFI and its own internal analysis, GSA decided to group the GSA ROB and the Cotton Annex into a smaller project, in part, due to investors' feedback to reduce the size of the project and the complexity associated with including the two Wright buildings and the Forrestal building complex.

Size: Written responses to the RFI suggested the need to focus the Project to ensure a financially and practically viable exchange. For example, five of nine respondents noted the complexities of exchanging all five buildings in one project. One respondent said that no one entity should or could take on the entire Project. Another respondent noted that the Project was too large and that to derive the most value, GSA needed to divide the buildings into distinct parcels to enable a series of smaller transactions. Another respondent also said that the unprecedented scope, scale, and complexity involved in GSA's proposed swap exchange were "daunting." Furthermore, two of nine respondents expressed interest in redeveloping both the GSA ROB and the Cotton Annex, yet only one of these respondents was interested in an exchange for these properties.⁹ Another respondent noted that GSA could likely move forward with the redevelopment of the Cotton Annex at any time.

Complexity: GSA officials told us that a swap exchange of the GSA ROB and the Cotton Annex could be expedited because some of the required environmental analyses had already been performed and each building is located on a single parcel of land requiring no infrastructure changes. In contrast, according to officials from GSA and the National Capital Planning Commission, exchanging the two Wright buildings and the Forrestal building complex presented additional risks to the Project. These three buildings are situated on more than 15 acres of land, and in the Planning Commission's discussions with the National Academy of Sciences about implementing the SW Ecodistrict Plan, the commission identified potential complex infrastructure issues associated with streets, water, and energy. For example, according to officials from the National Capital Planning Commission, new streets would have to be added to the neighborhood in order to conform to the L'Enfant Plan for Washington, D.C.—a plan that is listed on the National Register of Historic Places—and adding these streets would require extensive evaluations associated with local traffic and the environment. Furthermore, according to GSA officials, the Department of Energy had also expressed an interest in maintaining its headquarters on Independence Avenue, a potentiality that could have affected an investor's willingness to participate in the Project.

GSA's lack of experience with large swap exchanges presented additional risks. At the time GSA issued the RFI and reviewed the responses, the agency had limited guidance for such exchanges. In the past, we and the GSA's Office of Inspector General (Inspector General) have reported on GSA's limited guidance and its consequent risk to swap exchanges. We reported in 2014 that GSA lacked guidance for swap exchanges and recommended that GSA develop criteria for determining when to solicit market interest in a swap exchange.¹⁰ GSA agreed and

⁸ According to GSA officials, these buildings were part of the exchange because the conveyance of the GSA ROB would displace Department of Homeland Security employees and repairing these buildings could facilitate their consolidation and housing plan.

⁹ A total of two respondents were open to or supportive of a swap exchange.

¹⁰ [GAO-14-586](#).

implemented our recommendation in June 2014. Likewise, the GSA Inspector General has expressed concern about the agency's swap exchanges. In November 2013, the GSA Inspector General issued a memorandum noting that GSA's 1997 guidance on real property exchanges was not applicable to swap exchanges of real property for services.¹¹ At that time, GSA responded to the memorandum, saying that it was in the process of preparing guidance specific to exchanges for construction services and, in June 2014, issued additional guidance, with input based on experience with the ongoing Project. The GSA Inspector General has also expressed concerns about ongoing large swap exchanges, such as the Federal Triangle South and others GSA was pursuing.¹² The Inspector General stated that the risk associated with these projects is significantly increased because GSA had not performed such exchanges in the past. In particular, it noted the agency's lack of experience with large projects and limited options if the agency encountered a funding gap where the value of the property was less than the cost of construction. In addition, the Inspector General questioned if exchanges were the most cost-effective option for the government due to their complexities, extended time frames, and associated risks. Lastly, it noted the federal government could potentially obtain a better deal through the prescribed disposal process.

However, despite the decision to focus on two buildings, some risks remained. According to a GSA briefing to officials in the Office of Management and Budget, GSA stated that it continued to face challenges with the Project, including:

- undertaking an exchange of this magnitude, both in value and size, since no exchange of this size had yet to be successfully completed,
- the difficulties of minimizing risks in a process that is not frequently used, and
- potential investors would have to assume a substantial schedule, financial, technical and operational risk prior to any conveyance of development rights.

Nonetheless, GSA issued a request for qualification (RFQ) in April 2014 to identify qualified investors. The qualifications required were overall development experience, direct experience completing design/build projects, experience completing historic projects, and the investor's financial capacity and capability. As a result of responses to the RFQ, GSA issued a RFP in July 2015 to three privately owned real-estate investment firms that met the criteria in the RFQ. Each firm subsequently submitted a proposal that contained, among other things, its valuations of the GSA ROB and the Cotton Annex.

Investors' Valuations of the Properties Were Too Low to Make the Project Financially Viable and GSA's Experience with the Project Will Guide Future Swap Exchanges

GSA's Appraisal of Property Values Exceeded Estimated Construction Costs to Modernize GSA Headquarters

GSA officials initially believed that the swap exchange would be financially viable for the government because two independent real-estate appraisals done in 2015—one for the GSA ROB and the other for the Cotton Annex—showed a combined, appraised market value that exceeded the estimated construction costs to complete Phase 2 of the GSA headquarters

¹¹ General Services Administration, Office of Inspector General, *PBS Needs to Develop Policies and Procedures for Use of Section 412 Authorities*, Audit Memorandum A130132 (Washington, D.C.: November 2013).

¹² General Services Administration, Office of Inspector General, *Assessment of GSA's Major Management Challenges for Fiscal Year 2016* (Washington, D.C.: October 2015).

modernization. GSA officials said that any remaining value from the combination of the GSA ROB and the Cotton Annex would finance the renovation of up to four historic buildings at the planned Department of Homeland Security headquarters.

Investment Firms' Proposed Values Were Substantially Less Than GSA's Appraised Property Values

After evaluating the proposals submitted by three privately owned real-estate investment firms, GSA canceled the Project on February 18, 2016, having concluded in its Findings and Determination memorandum that the substantial differences between the appraised values for the GSA ROB and Cotton Annex did not make the exchange financially viable for the federal government. When we independently compared the values contained in proposals to the 2015 appraised values, we also found substantial differences in the values for each building, in part, due to differences in the assumptions and methodologies used by these investors.

Valuation Approaches Used by Independent Appraisers

For the GSA ROB, we found that the independent appraiser used a valuation methodology called an income approach after considering several methodologies. In this approach, the present value of real property is based on a projected income stream from the property, discounted by a “capitalization rate”—a projected rate of return that the investment property is expected to generate. At the request of GSA, the appraisal assumed that the GSA ROB would continue to exist in its current physical condition, use, and zoning—commonly called “As-Is” condition.

For the Cotton Annex (the building and the land parcel associated with the building), after considering several methodologies, the independent appraisal used a methodology called a sales comparison approach. This approach is based on the principle of substitution with the idea that an informed, rational, and prudent investor would pay no more than the cost to acquire a competitive property similar to the property being appraised (subject property) that has the same utility as of the valuation date. This approach also assumes there is an active and competitive market for properties similar to the subject and the prices paid for similar competitive properties are indicative of the most probable sale price for the subject. The appraised value assumed that the property would continue to exist in its current physical condition, use, and zoning, but may preclude demolition of the property since it would be subject to historic preservation covenants.¹³

Valuations Proposed By Private Investors

We found that the proposals from two of the investment firms valued the GSA ROB and the Cotton Annex substantially less than the appraised property value.¹⁴ For the GSA ROB, both proposals used a methodology similar to the independent appraiser—an income approach. However, factors that may have contributed to the substantial difference include assumptions related to rental income such as occupancy rates and present value such as capitalization rates.

¹³ The Cotton Annex is listed on the National Register of Historic Places.

¹⁴ A proposal from a third Investment firm did not estimate the value of either property, but indicated that the estimated construction cost at GSA headquarters alone exceeded the value of the properties to be exchanged.

In addition to differences in rates, investors considered the risk associated with the potential for higher interest rates on a loan to finance construction costs over several years, the value of time until the transfer of the property title from the government to the private investor, and the amount of time for the property to generate a net income. These risk factors, among others, presented substantial financial challenges to these private investors. For the Cotton Annex, the substantial difference in values may be attributed, in part, to the proposals from these two firms using an income approach to value the building as opposed to a sales comparison approach used in the appraised value.

According to GSA Officials, Experience with the Project Will Help Guide Future Swap Exchange Efforts

GSA officials told us that their experience with the canceled Project will help guide future efforts.¹⁵ As we previously discussed, this experience contributed to the development of GSA's 2014 guidance on swap exchanges and a recognition that a private investor would have to assume substantial risk. In addition, GSA officials identified the following actions that they plan to take to improve swap exchange processes:

- *Appraisals:* Improve the appraisal process for buildings involved in swap exchanges by (a) informing appraisers of the swap exchange's goals, objectives, and processes; (b) allowing appraisers to consider a range of values for uncertainties related to zoning and other economic assumptions; (c) encouraging appraisers, when appropriate, to develop methodologies that take into consideration large and complex swap exchanges.
- *Insights from Stakeholders and Investors:* Hold discussions with (a) industry experts to identify potential project risks and appraisal methods, among other things and (b) potential investors to understand their views related to risks and how they plan to mitigate such risks.
- *Address Uncertainties:* To the extent possible, address and resolve or mitigate uncertainties related to zoning, entitlements, historic preservation, environmental conditions, project scope, costs and schedule and additional identified risks.

Agency Comments

We provided a draft of this report to GSA for review and comment. GSA provided technical comments which we incorporated as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 7 days from the report date. At that time, we will send copies of this report to the Administrator of GSA, appropriate congressional committees, and other interested parties. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staffs have any questions concerning this report, please contact me at (202) 512-2834 or wised@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report were Edward Laughlin (Assistant Director), Camilo Flores, Ross Gauthier, Delwen Jones, Terence Lam, Steve Martinez, Jon Melhus, Josh Ormond, Kelly Rubin, and Larry Thomas.

Sincerely yours,



David J. Wise
Director, Physical Infrastructure Issues

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¹⁵ As of January 12, 2016, GSA had other planned or ongoing swap exchange projects, such as the Federal Bureau of Investigation and the Department of Labor headquarters buildings in Washington, D.C.