



Office of Inspector General

AUDIT OF DEPARTMENT OF VETERANS AFFAIRS LEASED SPACE

While leases were generally economically established and properly administered, VA should ensure lease requirements are reasonable and should provide additional lease training for contracting officers.

Report No. 8R5-D05-004
Date: October 8, 1997

Office of Inspector General
Washington DC 20420



DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

Memorandum to the Under Secretary for Health (10)

Audit of Department of Veterans Affairs (VA) Leased Space

1. The purpose of the audit was to determine whether VA leases were economically established and to evaluate the effectiveness of the lease administration process. Nationally, VA has approximately 650 leases with an annual expenditure of \$171 million.
2. We reviewed space leased by VA or assigned by the General Services Administration (GSA) as of March 31, 1996. We audited leases at seven Veterans Health Administration (VHA) facilities, three Veterans Benefits Administration (VBA) facilities, and VA Central Office. We selected specific facilities for audit because they had significant numbers of leases, different types of leased space, and some leases with large annual lease costs. Our review included 74 leases (65 leases that were negotiated by VA contracting officers and 9 in which GSA assigned space to VA in GSA owned or leased space) with annual costs of \$24.2 million. We reviewed the 65 lease procurement files for VA initiated leases to evaluate whether leases were economically established by VA contracting officers at Department of Veterans Affairs medical centers (VAMCs). In addition, based on indicators from the review of the 9 GSA leases, we reviewed the rental rates VA pays GSA for 90 leases in commercial space, as of March 16, 1997, to determine whether the rates were reasonable. We also assessed the effectiveness of the lease administration process.
3. Based on the leases in our sample, VHA and VBA generally established the leases economically, reduced leased space when appropriate, and administered the leased property effectively. VBA negotiated rental rate reductions when GSA billed for more space than VBA actually occupied and when commercial rental rates declined. VBA also reduced space when the number of employees declined and established a goal of reducing annual lease costs by \$8 million by Fiscal Year 1999. However, we also found that VA paid another government agency for warehouse space prior to the effective date of the lease, did not collect monetary damages for late occupancy on another lease, and required a 90-day termination clause in Vet Center leases that restricted competition. VA is also

paying GSA significantly more than the market rate for some leased space procured from commercial lessors.

4. VHA's medical facility contracting officers were not adequately documenting that competition was solicited for leases. Also, VHA is considering increasing the approval thresholds for VAMC contracting officers from \$300,000 to \$1 million that would allow direct negotiation for leases valued up to \$1 million. If VHA increases the approval thresholds, not all facilities will have contracting officers with the proper lease training and experience.

5. We made recommendations to seek recoveries and damages for the two leases in which VA was either overcharged or not provided the space when promised and to eliminate the 90-day termination clause in Vet Center leases. We also made a recommendation to develop procedures to ensure that GSA rental rates are consistent with current fair market values and to appeal rates found to be significantly higher. Finally, we made recommendations to delay plans to increase contracting officer lease approval authorities, improve training for VAMC contracting officers, and improve documentation of the lease process in the lease files. You concurred with the recommendations and the estimated monetary efficiencies, and you prepared acceptable implementation plans. We consider all audit issues resolved and will follow up on the implementation plans until they are completed.

For the Assistant Inspector General for Auditing

(Original signed by:)

WILLIAM D. MILLER

Director, Kansas City Operations Division

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RESULTS AND RECOMMENDATIONS

1. Most VA Leases Were Economically Established and Properly Administered

Executive Order 12411, dated September 20, 1989, requires that each agency reduce lease costs and use space more effectively. The order directs agencies to reduce the total amount of space used, minimize office space, and return excess space to the General Services Administration (GSA). Also, it requires each agency to establish a space inventory and submit annual statistics on leased property to GSA. Both the Veterans Health Administration (VHA) and the Veterans Benefits Administration (VBA) have taken effective actions to control leased space. VHA kept administrative costs to a minimum by economically establishing and effectively administering most leases. For longer lease acquisitions, VHA staff prepare an analysis to determine whether it is more cost-effective to lease or purchase the space. Also, both VHA and VBA established a space inventory for the listing of leased space. VBA negotiated reduced rental rates when GSA billed for more space than VBA actually occupied and when commercial rental rates declined. VBA reduced space when the number of employees declined and established a goal of reducing annual lease costs by \$8 million by Fiscal Year (FY) 1999. In our view, these steps were reasonable and responsive to the executive order.

VHA Economically Established and Properly Administered Most Leases

The first audit objective focused on determining whether leases were economically established and whether Department of Veterans Affairs medical centers (VAMCs) reduced administrative costs. For 65 VHA initiated leases, the market surveys, property appraisals, or other documents showed that rental rates were economical. Also, facilities reduced administrative costs. For example, one VAMC avoided lease costs by canceling a lease for space used by the Home Hemodialysis Training Program and began housing patients in a VA owned lodging unit, saving \$26,700 annually.

The second audit objective focused on evaluating the effectiveness of the lease administration process. We reviewed lease files and interviewed facility staff to determine if contracting officers effectively administered lease contracts. A review of timeliness of space delivery, payments, and maintenance showed effective contract administration. For example, maintenance problems occurred for eight leases and the contracting officers made the lessors correct the problems. One facility effectively used cure letters—letters that are designed to give the lessors a choice of either making the repairs themselves or allowing VA to make the repairs and deduct the cost from the lease payments.

VBA Determined that GSA Overbilled for the Amount of Space Occupied and for Rental Rates

For assigned space in GSA owned buildings, VBA requested that VA Regional Office (VARO) Directors verify the space occupied to determine if the square footage billed by GSA was accurate. Staff at two VAROs found, after measuring their assigned space, that GSA billed for 34,750 more square feet than VBA actually occupied. GSA reduced the lease costs at the two VAROs to reflect the correct amount of space occupied, saving VBA \$1.03 million for FY 1997.

VBA also requested that VARO Directors compare the GSA rental rates with commercial rental rates for their areas. When commercial rental rates declined, two VAROs negotiated reduced rental rates with GSA and saved VBA \$978,000 for FY 1997.

VBA Reduced Space When the Number of Employees Decreased

Another audit objective focused on evaluating if VBA reduced the amount of leased space as the number of employees was reduced. VBA staffing declined 10.8 percent from FY 1992 through FY 1996. In March 1995, as part of the strategic planning process, VBA analyzed space usage by comparing GSA space standards to the number of employees and the amount of space assigned to each VARO.¹ The analysis identified five VAROs with excess space. Space at the other VAROs was either below the GSA space standards or above the GSA space standards by an immaterial amount. For the five VAROs, VBA's Strategic Management Committee asked Area Directors to reduce the amount of leased space and lease costs in FY 1998. The 5 VAROs plan to reduce space by 18 percent with a corresponding FY 1998 cost savings of \$1.2 million.

In January 1997, VBA's Strategic Management Committee established a goal of reducing lease costs by 10 percent of the projected \$80 million annual lease costs for FY 1997. This would result in savings of \$8 million by FY 1999. The committee asked the four Area Directors to develop and implement plans to reduce the lease cost.

VHA Recognized the Lease Inventory Was Not Accurate

According to Executive Order 12411, dated September 20, 1989, and implemented in 41 Code of Federal Regulations, Part 101-3, agencies are required to establish a space inventory and to annually report statistics to GSA on real property owned and leased. The data must be accurate as of the last day of the fiscal year. To meet the reporting

¹ GSA standards allow 212 square feet per employee. This includes 125 square feet per person plus 22 percent for administrative space and 60 square feet for file storage. Also, VBA prepared a draft Design Guide as a tool to show the functional requirements necessary for proper operation of a VARO.

requirement, VHA and VBA staff created an inventory of VA leased space and updated it annually.

We reviewed the leased space inventory as of the last day of FY 1995 to determine whether it was accurate. Our sample of 74 leases included 62 awarded before September 30, 1995. We found some errors in the VHA space inventory. For example, it contained three expired leases and six duplicate entries. Also, the information for 29 leases contained errors such as the amount of annual rent, amount of space, lease period, or contract number. As a result, this information was inaccurately reported to GSA. However, VHA staff had already taken steps to improve the accuracy of the inventory listing by contracting with a consultant to correct the deficiencies.

VHA Needs to Correct Minor Exceptions

Although VHA economically established and properly administered most leased space, we did identify four exceptions.

- VA paid another government agency for warehouse space from the date the negotiations started to the effective date of the lease, a time when VA did not occupy the space. This amounted to 142 days and cost VA \$7,700. The lease number was V640-R-0031.
- One lessor delivered leased space 60 days late. Radiology equipment was delivered 15 days after the lessor was to deliver the space, and VA had to pay leasing costs of \$5,948 on the radiology equipment that could not be used for 45 days. Staff did not collect monetary damages. The lease number was V612(RE) 91-32.
- A 14-space parking lot was used by program participants only 2 days a month. VA agreed to cancel the lease, saving \$6,000.
- Readjustment Counseling Service (RCS) required a 90-day termination clause for all Vet Center leases. Our review found that the 90-day termination clause restricted competition. For 2 of 17 Vet Center leases, property owners would not submit a bid because of the 90-day termination clause. For 4 of 17 Vet Center leases, the lessors insisted that a cancellation fee be included to protect them against VA's 90-day termination clause.

(See Appendix III, Page 17 for further discussion of these three leases and the 90-day termination clause.)

Recommendation 1

We recommend that the Under Secretary for Health:

- a. Explore options to determine if VA can recover the \$7,700 paid to the other government agency for warehouse space prior to the effective date of the lease.
- b. Explore options to determine if VA can collect liquidated damages for the late occupancy for lease V612(RE) 91-32.
- c. Eliminate the requirement for 90-day termination clauses in Vet Center leases. Delegate authority to the RCS Regional Directors to include the 90-day termination clause on a case-by-case basis as needed.

Recommendations 1a and 1b are subject to MP-4, Part IV, Chapter 5 reporting requirements.

The associated monetary benefits for Recommendation 1 are shown in Appendix IV on page 23.

Under Secretary for Health Comments

Recommendation 1a. Concur. VHA's Lease Management Service, in close coordination with attorneys from the General Counsel Office, will thoroughly review this contract file to initially determine the legal potential for successful recovery of the fee. Negotiations with the lessor will be conducted as appropriate, and, if a mutually agreeable resolution is not forthcoming, a determination will be made about whether additional legal action is indicated. Implementation: November 30, 1997.

Recommendation 1b. Concur. The Lease Management Office will assess collection options for this lease in conjunction with their review of the case identified in Recommendation 1a. The same procedures and timelines will be followed. Implementation: November 30, 1997.

Recommendation 1c. Concur. This requirement has been eliminated. VHA Directive 7815, *Acquisition of Real Property by Lease and by Assignment from GSA*, which is in the process of final Departmental concurrence, specifically addresses termination issues: "No termination clause will be required. The RCS Regional Manager may include such a clause if it is determined to be in the best interest of veteran care. If this clause is included in the lease, it must have been added at the time the solicitation or specifications for SLAP were formulated." Implementation: September 30, 1997.

Office of Inspector General Comments

The Under Secretary for Health concurred with the recommendations and provided acceptable implementation plans. We consider all audit issues resolved and will follow up on the implementation plans.

2. VA Needs to Ensure that Rental Rates Paid to GSA Are Reasonable

VA is paying GSA significantly more than the market rate for some leased space procured from commercial lessors. This occurs because VA does not have procedures in place to ensure that the price GSA charges approximates the current market value. As a result, the rent that VA pays GSA for commercial space is not cost effective.

VA Is Paying More Than Current Market Value in Some Cases

GSA paid the lessors \$33.7 million in annual rent for the 90 leases that it procured for VA. As of March 16, 1997, VA paid GSA \$4.9 million more (a total of \$38.6 million) in annual rent for the same space, an increase of 14.5 percent.

This occurred because the rate GSA charges VA for rent is based on the current market value of the space regardless of the rate GSA pays. GSA charges federal agencies rent for the space they occupy, and the rents should be comparable to local commercial rents. GSA uses the rents to pay building capital and operating expenses, including the costs of leasing space. Currently, GSA's rent system is based on a 5-year cycle. Every five years, GSA uses contract appraisers to perform appraisals on all GSA buildings to arrive at market rates for office space. GSA then computes various adjusted rates for special purpose space such as general storage and food service as shown below. These adjusted rates are based on construction costs for special purpose space. However, the tenant agency generally pays the cost of renovating the space for special use in a lump sum payment, so, in such cases, the tenant agency is paying twice for the same renovation. The following example assumes an appraised office rate of \$10.25 per net square foot.

<u>Type of Space</u>	<u>Construction Ratio</u>	<u>Office Rate</u>	<u>GSA Adjusted Rate</u>
General Storage	0.70	\$10.25	\$ 7.18
Lab and Clinic	1.79	\$10.25	\$18.35
Food Service	1.64	\$10.25	\$16.81
Structurally Changed	1.80	\$10.25	\$18.45
ADP	1.58	\$10.25	\$16.20
Conference & Training	1.19	\$10.25	\$12.20
Light Industrial	0.85	\$10.25	\$ 8.71

Rates for inside parking, outside parking, warehouse, and quarters and residences are based on separate appraisals. GSA adjusts the rates for the second through fifth years annually according to private sector methods designed to maintain commercial comparability, such as the Consumer Price Index.

In October 1996, GSA began to permit federal agencies to lease office space directly with the lessors. Under a new program, agencies now have the option of leasing on their own or using GSA's new competitive program. However, agencies needing space are still required to request space from GSA. If GSA has appropriate space in inventory, the agency is required to accept that space. If suitable space is not available in the current inventory, the agency has the opportunity to procure its own space or utilize GSA's services to acquire the needed space.

Along with giving federal agencies the choice of procuring their own space, GSA also planned to change the way it charges agencies for space. Under the proposed new system, GSA would negotiate a lease for the space and charge the tenant agency the cost of the negotiated rent plus a fee for the administration of the lease. The fee would be a variable percentage of the total contract value of the lease, and the maximum rate would be 3.5 percent. Additional fees for property management, security, and lease indemnification would also be charged. GSA has not enacted this new policy, because, according to a GSA Office of Portfolio Management official, it is awaiting approval from OMB. It is not scheduled to be fully enacted until FY 1999. However, GSA has received permission to use the new pricing policy after October 1, 1997, for any new leases with an agency that agrees to accept the policy.

Under the current rules, federal agencies do not have the opportunity to appeal a rate charged by GSA unless they can show that the rate GSA charges is at least 25 percent or one dollar per square foot, whichever is greater, above the current market rate or when the quarterly rent charge exceeds current market value by more than \$25,000. We requested current market rates for a sample of 12 properties from VA's Real Property Management Office to determine if VA was paying rates in excess of current market value. We found that in five cases, the rates that VA paid met GSA's appeal criteria. In 4 cases, the rate GSA charges is at least 25 percent above the current market rate and in all 5 cases, the quarterly rent charge exceeds the current market value by more than \$25,000 as shown in the chart below. In addition, the rates that VA paid GSA were significantly greater than the rates GSA paid the lessors.

<u>Location</u>	<u>Lease Number</u>	<u>Rate GSA Pays</u>	<u>Market Rate</u>	<u>Rate VA Pays GSA</u>	<u>Annual Rent Difference Between Market Rate & VA Rate</u>
Ann Arbor, MI	AMI40316	\$24.25	\$16.00	\$31.94	\$589,509
Canton, OH	AOH00040	\$11.96	\$16.00	\$25.07	\$432,294
Muskogee, OK	AOK60114	\$7.05	\$10.50	\$12.62	\$148,065
Providence, RI	ARI30072	\$20.68	\$18.00	\$29.33	\$292,133
Grand Prairie, TX	ATX62086	\$15.10	\$11.50	\$21.76	<u>\$165,740</u>
Total					<u>\$1,627,741</u>

In three other cases, the rate that VA paid GSA was only slightly higher than market value. In the remaining four cases, the rate that VA paid is lower than current market value. However, in all four of these cases, the rate that VA paid was still significantly higher than the rate that GSA was paying the lessor for the space.

VA does not have a system in place to monitor the rental rates that GSA imposes to ensure that the rates approximate the current market rate for the area. VA officials stated that it can cost up to \$5,000 to perform an appraisal for each location and VA funds are not available to perform an appraisal on every lease obtained through GSA. However, there are lower cost alternatives available to aid VA in determining whether the rental rates charged by GSA are comparable to the current market rates. The Building Owners and Managers Association International (BOMA) publishes an annual report that provides rent rate ranges for numerous cities. The BOMA report could be used to identify those GSA rates that appear excessive. VA could procure appraisals on those properties to verify whether the GSA rates are significantly higher than current market values. If VA determines that it is paying an unreasonably high rate, it should appeal the rate to GSA using the appraisal as support.

VA Central Office officials agreed that such a review was necessary but expressed concern with their lack of resources to execute this procedure. We suggested that the responsibility to monitor and identify the excessive lease rates be delegated to the field offices.

Recommendation 2

We recommend that the Under Secretary for Health develop procedures to ensure that GSA rental rates are consistent with current fair market values and appeal any rates found to be significantly higher.

The associated monetary benefits for Recommendation 2 are shown in Appendix IV on page 23.

Under Secretary for Health Comments

Recommendation 2. Concur in principle. It is reasonable to assume that it is GSA's responsibility to assure that established GSA rental rates reflect current fair market value, and that federal agency itself claims that such is the case. Although OIG's findings suggest that such is not always the case, few, if any field concerns have been raised about GSA overcharges.

Nevertheless, we agree that it might be useful if a mechanism were in place to ensure that, if GSA rates are not consistently in line with fair market value, appropriate appeal

processes can be initiated by field facilities. However, we have not yet been able to identify a workable method to achieve this oversight that does not require extensive research, computation, analytical review and calculation of an enormous amount of real estate data by staff in our Lease Management Service. Given the effects of VHA downsizing actions, staff are stretched to the limits in fulfilling functional duties, and both cost and anticipated benefits must be carefully weighed before additional responsibilities are added.

You recommend that field staff utilize the BOMA report of national rental rate ranges as a resource tool in identifying potential out-of-line rental charges. This document is highly technical and designed specifically for interpretation by experienced professionals in the real estate field. The complexity of the document, we believe, would deter any practical use by most of our field contracting officers, since few have extensive expertise in realty management.

Lease Management Service will continue to assess methods that might be useful in providing opportunities for comparing relevant market data with GSA rent data. Preliminary attention will be given to assuring that VISN and field facility staff are made fully aware of issues addressed by OIG. During regularly scheduled teleconference calls, such as a weekly Chief Network Officer call and other communication routes (i.e., FORUM mailgroups, program office newsletters, VHA directives, etc.), the importance of periodically comparing GSA rates with current community market values will be stressed. Staff will be encouraged not to routinely accept GSA leasing rates without question, but, rather, to make at least rudimentary contacts with local realtors and building management organizations to get a sense of current leasing rates for similar properties. As possible out-of-line GSA charges are identified, follow-up contact with the Lease Management Service will be initiated to further explore whether an appeal process is indicated. As part of their efforts, staff will also contact selected federal agencies that rely heavily on GSA rental properties to determine if similar irregularities in rental charges have been also identified. Findings of your audit might also be shared with GSA representatives in an attempt to better understand their methodologies and to determine if that agency is taking steps to streamline its own processes. Implementation: December 1997 and ongoing.

Office of Inspector General Comments

The Under Secretary for Health concurred in principle with the recommendation and provided acceptable implementation plans. We consider all audit issues resolved and will follow up on the implementation plans.

3. VHA Needs to Provide Additional Lease Training before Increasing the Approval Threshold for VAMC Contracting Officers

VHA authorized contracting officers at medical facilities to negotiate leases under \$300,000, and provided instructions on competitive negotiation procedures. However, we found that many contract files did not contain adequate documentation to confirm that competition was solicited. The required documentation should have included evidence of authority to negotiate leases, market surveys, property appraisals, and legal reviews. The documentation was missing because contracting officers said that they misunderstood requirements, such as documenting market surveys and obtaining property appraisals, and were not familiar with all leasing procedures. VHA is considering increasing the approval thresholds for contracting officers, allowing them to negotiate contracts with costs up to \$1 million. Before proceeding with the increased thresholds, the Director, Real Property Management Office asked us to review contracting officers' lease training and work experience. We did the review and found that, if VHA increases the approval thresholds, not all facilities will have contracting officers with the proper lease training and experience.

Lease Files Did Not Contain All Required Acquisition Steps

VHA issued Circular 00-90-22, dated August 16, 1990, and Directive 10-94-057, dated July 1, 1994, listing procedures for acquiring leased space by competitive negotiation. We reviewed 65 leases that VA initiated to determine if contracting officers followed VA's space acquisition procedures. For 57 of the 65 leases, the contract files did not contain all the mandatory acquisition documents, such as evidence of authority to negotiate leases, market surveys, property appraisals, and legal reviews. *(See Appendix III, Page 19 for further discussion of documents missing from lease contract files.)*

We discussed the leases with contracting officers at the seven VAMCs we audited to determine why they did not document all acquisition steps. Contracting officers said that they misunderstood requirements, such as to document market surveys and to obtain property appraisals, and were not familiar with all leasing procedures. From June to August 1996, VHA provided some lease training to contracting officers. Although most of the leases we reviewed were established prior to the 1996 training, some contracting officers told us they were still not familiar with all the leasing documentation requirements because they did not negotiate any leases after the training.

Training at Some Facilities Was Not Adequate

To determine if contracting officers received lease training and had experience in leasing, we asked each VHA facility, through the use of a questionnaire, to provide us with a profile of training courses and work experience for all contracting officers involved with the leasing process. We received information from 137 VHA facilities. Our analysis showed that 19 of 137 facilities did not have a contracting officer who attended the lease training provided in 1996. Also, 10 of 137 facilities did not have a contracting officer with leasing experience.

GSA delegated authority to VA to lease medically related space and required VA to use adequately trained contracting officers for lease acquisitions. GSA suggested five training courses to be offered to contracting officers. We asked if contracting officers received training in the five leasing related courses suggested by GSA. None of the VA contracting officers had received all five training courses or their equivalents.

We analyzed whether VAMC contracting officers have the warrant level, experience, and training to negotiate leases up to the proposed \$1 million threshold. According to Veterans Affairs Acquisition Regulation 801-690-2, only contracting officers at the senior warrant level can negotiate the proposed increased dollar threshold of contracts. We found 56 of 137 facilities have senior contracting officers with both leasing training and experience. The remaining 81 facilities do not have senior warrant level contracting officers with both training and leasing experience.

Recommendation 3

We recommend that the Under Secretary for Health:

- a. Emphasize the need to properly document the lease process through periodic telephone conference calls or additional training as needed.
- b. Increase facility leasing authorities on a case-by-case basis only. Delay additional delegations to facilities who do not have senior warrant level contracting officers with lease training and experience until proper training has been accomplished.

Under Secretary for Health Comments

Recommendation 3a. Concur. Lease Management Service is in the process of requesting funding for a week-long training seminar in lease administration for all field contracting officers. Included throughout the training agenda will be emphasis on all aspects of what constitutes appropriate documentation. If funded, the course is targeted for the third quarter of FY 1998.

In the meantime, periodic conference calls will be held to reinforce already published procedures relating to leasing documentation. The conference calls will be geared primarily for contracting support staff in all of the Network offices, who will share information with their respective field facilities. Implementation: March 1998.

Recommendation 3b. Concur. The existing directive is in the process of being extended and no increased facility leasing authorities will be provided. Any lease above the existing dollar thresholds referred to by OIG will continue to be submitted to the Lease Management Service for approval of authority to negotiate.

Office of Inspector General Comments

The Under Secretary for Health concurred with the recommendations and provided acceptable implementation plans. We consider all audit issues resolved and will follow up on the implementation plans.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

The purpose of the audit was to determine whether leases were economically established and to evaluate the effectiveness of the lease administration process.

Scope and Methodology

The scope of the audit included real property leased by VA, but excluded VA's enhanced use leases. Also, the scope did not include an audit of the Benefit Cost Analysis process which VHA staff uses to determine whether to lease or to construct new space. According to the Direct Leases Inventory and the Federal Buildings Fund Rent Report obtained from VHA's Real Property Management Office, VA had 654 leases costing \$171 million annually, as of March 31, 1996.

We initiated our audit with a review of VHA Directives and GSA requirements and prior OIG and GAO audits to identify requirements and potential audit issues. Seven VHA facilities, three VBA facilities, and VA Central Office were selected for review from groups of geographic clusters. We selected clusters with facilities that had larger numbers of leases, a variety of different types of leased space, and some leases with higher lease costs than others in the cluster.

In the initial phase of our audit, we reviewed 74 leases as described below that had annual rent costs of \$24.2 million.

<u>Type of Lease</u>	<u>Number</u>
VA Initiated Leases	
Negotiated by VAMC contracting officers	50
Negotiated by VA Central Office contracting officers	<u>15</u>
Subtotal	65
GSA Assigned Space to VA	<u>9</u>
Total Leases Reviewed	<u>74</u>

Five major reviews and tests were included in the initial phase of our audit as described below.

- Reviewed lease procurement files to determine whether VA obtained economical rates and used the proper procurement process.
- Reviewed lease administration files to determine who is using the leased space, if lessors properly maintained the property, if space was delivered timely, and if changes were made to the property.
- Interviewed appropriate facility staff to determine the local leasing process and identify maintenance problems.
- Reviewed accounting records to verify lease costs.
- Reviewed VBA lease folders from Area Director offices, lease costs, and analyses to identify actions taken to reduce space.

In the second phase of our audit, at the request of the Director, Real Property Management Office, we sent questionnaires to medical facilities to identify the training received by contracting officers. We analyzed the information to identify training needs. Also, for 12 leases, we compared rental rates paid by VA to current market rates for the same space to determine if the rates VA paid were reasonable. VA pays annual lease costs of \$38.6 million to GSA for 90 leases.

We used automated VA data for two purposes. First, we used the number and cost of leases from the Direct Lease Inventory, a database developed by Real Property Management Office, to identify potential audit sites. Second, we used the data to identify the universe of leases at individual sites. The data was not critical to the accomplishment of the audit objectives. The reliability of the data was assessed by comparing the database to source documents and financial billings. As noted in Issue 1 (page 3), the database was inaccurate. However, we concluded the data was sufficiently reliable to be used in meeting the assignment's objectives.

The audit was made in accordance with generally accepted government auditing standards and included such tests of the procedures and records as were deemed appropriate under the circumstances. Internal controls pertaining to the areas reviewed were analyzed and evaluated. The audit included program results, economy and efficiency, and financial and compliance elements.

BACKGROUND

The Federal Property and Administrative Services Act of 1949 and the Reorganization Plan No. 18 of 1950 granted GSA the statutory authority to lease real property and to manage leased facilities. The Act limited each lease to no more than a 20-year term. GSA delegated to the Secretary of Veterans Affairs authority to lease space for hospitals. GSA required VA to follow General Services Acquisition Regulations (GSARs) in the acquisition of space. A Memorandum of Understanding (MOU), issued September 28, 1983, expanded the leasing authority to include outpatient clinics and other medically-related space. A February 6, 1995, clarification to the MOU provided the Secretary with authority to lease general purpose space to provide administrative support to medical facilities.

The Secretary was not delegated authority from GSA to lease space for VBA and VA Central Office activities. For VBA and VA Central Office space, GSA either procures leased space or assigns space in GSA-owned buildings.

The Secretary delegated the following approval authority for medically-related leased space:

- The Directors, VAMCs, VA Medical and Regional Office Centers, and Independent Outpatient Clinics are delegated authority to approve and negotiate leases under 10,000 square feet, under 100 parking spaces, and with annual rent under \$300,000 when local funding is used. The facility contracting officers negotiate the leases.
- VA Central Office staff must approve leases over 10,000 square feet, over 100 parking spaces, or over \$300,000 in annual rent. Contracting officers from the Real Property Management Office negotiate the leases.

The Real Property Management Office has the program responsibility for VA leased space. VA had 654 leases with annual lease costs of \$171 million as of March 31, 1996, as shown on the following chart.

APPENDIX II

VA Leases (Cost in millions)

<u>Organization</u>	<u>VA Negotiated</u>		<u>GSA Assigned</u>		<u>Total</u>	
	<u>No.</u>	<u>Cost</u>	<u>No.</u>	<u>Cost</u>	<u>No.</u>	<u>Cost</u>
VHA	468	\$51.2	69	\$ 19.6	537	\$ 70.8
VBA	0	0	94	\$ 61.1	94	\$ 61.1
VACO	<u>0</u>	<u>0</u>	<u>23</u>	<u>\$ 39.1</u>	<u>23</u>	<u>\$ 39.1</u>
Totals	<u>468</u>	<u>\$51.2</u>	<u>186</u>	<u>\$119.8</u>	<u>654</u>	<u>\$171.0</u>

DETAILS OF AUDIT

Description of Minor Exceptions

VA Paid for Warehouse Space Before It Was Available

A VAMC needed additional warehouse space, so a contract was negotiated with a government agency to lease a warehouse at an annual cost of \$19,800 for 3 years. The VA contracting officer signed the lease, number V640-R-0031, and obtained possession of the warehouse on June 7, 1995. As a condition of signing the lease, the other agency insisted on payment from VA for the space from January 16, 1995, when negotiations started, through June 7, 1995, a total of 142 days. VA paid \$7,700 for storage space that was not yet available.

Monetary Damages Should Be Collected

For lease V612(RE) 91-32 dated November 1, 1991, VA did not obtain delivery of leased space by the occupancy date stated in the contract. The lease, for a radiology suite, included a damage clause which stated the lessor would be liable for any damage to the Government resulting from the lessor's failure to deliver the space ready for occupancy within the specified time. The suite was scheduled for occupancy on November 1, 1991, and it appears it was occupied on December 31, 1991. In mid-November, radiology equipment, leased for \$3,965 per month, was delivered. VA incurred unnecessary storage expenses and paid \$5,948 (\$3,965 x 1.5 months) for equipment that could not be used. We found no evidence the contracting officer collected monetary damages from the lessor. In our opinion, contracting staff should request a legal opinion on whether VA can collect monetary damages.

A Parking Space Lease Was Not Needed

A 14-space parking lease was awarded for a 1-year term beginning October 1, 1996, at an annual cost of \$7,200. The lease was for parking by VA employees attending educational programs at the Regional Medical Education Center (RMEC). The spaces were used by the program participants two days a month. During the remaining working days, RMEC staff used the parking spaces at no cost to the staff. Employees attending RMEC were on temporary duty travel, and it would be more cost-effective to have training participants pay for commercial parking and claim expenses on their travel vouchers. At our suggestion, the parking space lease was canceled effective December 1, 1996, for an approximate cost savings of \$6,000. *The associated monetary benefits are shown in Appendix IV on page 23.*

Eliminating the 90-Day Termination Clause Should Improve Competition

Readjustment Counseling Service required a 90-day termination clause for all Vet Center leases. VHA officials said the purpose of the 90-day termination clause was to allow Vet Centers to cancel undesirable leases. However, none of the 17 Vet Center leases we reviewed had been canceled using the 90-day termination clause, and none of the contracting officers at the centers we visited had ever cancelled a lease using the clause.

Our review found that the 90-day termination clause restricted competition. For 2 of the 17 leases, property owners would not submit bids because of the 90-day termination clause. For one Vet Center, a bidder refused to sign a lease containing the 90-day termination clause. For the second Vet Center, the contracting officer sent a solicitation to five real estate companies, but they would not submit bids because of the 90-day termination clause. The contracting officer stated in the price negotiation memorandum, “As long as we must include the 90-day out clause in Vet Center leases, it will be very difficult to obtain more competition and nearly impossible to relocate.” Also, for 12 other Vet Centers the contracting officers received only one bid for each solicitation.

Also, the lessors insisted on including a cancellation fee in four of the Vet Center leases with 90-day termination clauses. The lessors wanted the cancellation fee to recoup all costs if VA exercised the 90-day termination clause. The cancellation fees made the 90-day termination clause very expensive. For example, the first year cancellation fee for one lease was \$64,063, which exceeded the annual rent of \$43,000. The 90-day termination clauses in Vet Center leases should not be required routinely, but could be included on a case-by-case basis as needed.

Documents Missing From Lease Files and Procedural Errors

VHA Circular 00-90-22 and VHA Directive 10-94-057 list procedures for acquiring lease space by competitive negotiations. The Acquisition of Leasehold Interest in Real Property Handbook requires the lease contract file to contain all documents relating to the lease award. We reviewed lease contract files for 65 VA initiated leases. For 57 VA initiated leases, contracting officers did not adequately follow procedures and maintain documentation. The following paragraphs describe procedures and documents that were missing from the lease files.

Directors Approval

The Secretary of Veterans Affairs delegated to Directors of VA medical facilities the authority to approve leases costing less than \$300,000. The Directors provide the contracting officers with letters of authority to negotiate leases. Eight lease contract files did not contain the letters of authority to negotiate.

Space Requirements Package

The contracting officer should receive a space requirements package providing information about the amount, dimensions, and type of space and the number of employees, patients, and visitors that will use the space. The contracting officer is responsible for reviewing the information in the package to ensure requirements are clearly defined. In addition, the space requested should not exceed space criteria based on projected workloads. Thirteen contract files did not contain space requirements packages.

Market Survey

The contracting officer should perform a market survey to identify property, to determine the quality of the property, to determine if the property meets requirements, and to ensure the rental rate is reasonable compared to rent on similar property. The contracting officers did not perform market surveys for five leases. Also, the contracting officers did not include the required market survey forms in the contract files for six leases. In one instance, there was evidence that a market survey was accomplished, but it was not documented.

Property Appraisal

GSAR 570 requires an appraisal to be prepared by a real estate appraiser, in accordance with real property appraisal procedures, to serve as evidence that the lease cost is reasonable. For seven leases, the contract files did not contain property appraisals. For

one other lease, other documents indicated an appraisal was done, but the appraisal was not in the lease file.

Lack of Competition

Lease contracts should be awarded by using competitive procurements in which the contracting officer negotiates with at least three bidders. When leases are awarded without competition, for example with only one bidder, the contracting officer must prepare a "Justification for Other than Full and Open Competition" to justify why competition was not used and to obtain approval to award the lease. Ten leases did not have the required written justifications and approvals, and they were awarded without competition.

Lease Terms

Circular 00-90-22, issued in 1990, requires all leases, except for warehouses, to have a lease term, or length, not to exceed 5 years and renewal options not to exceed 5 years. VHA Directive 10-94-057, dated 1994, changed the lease term by requiring leases to have a lease term not to exceed 3 years. Warehouse leases are limited to 1 year, with two 1-year renewal options. Contracting officers negotiated six leases with lease term authorizations exceeding these time periods.

Inappropriate Use of Supplemental Agreements

Contracting officers can negotiate a supplemental lease agreement to extend a lease on a short-term basis, usually not to exceed 1 year. This authority is for unexpected delays encountered in signing new leases. We found two leases with supplemental agreements to extend leases for longer periods of time. One lease that expired was extended an additional 5 years, and the second lease was extended nearly 3 years.

Lease Form

The lease file should contain the signed lease. For two leases, VA Forms 90-2237 "Request, Turn-in, and Receipt for Property of Services" were used in place of the lease forms and did not contain the needed contract clauses.

Price Negotiation Memorandum

The lease contract file should contain documents showing the basis for evaluating bids and a summary describing how the lease was awarded. Contracting officers should prepare a price negotiation memorandum to record this information. Contract files for seven leases did not have price negotiation memorandums.

Legal Review

District Counsel must determine if the lease meets legal requirements before the contracting officer executes, or signs, the lease. For 19 leases, legal reviews were not obtained. For one lease, the contracting officer submitted the request for legal review after lease award. For six other leases, the contracting officer submitted requests for legal reviews but awarded the leases before completion of the legal reviews.

Inspection and Acceptance

The contracting officer, along with engineering staff, should inspect the space to determine if the space is acceptable for occupancy. Inspection reports were not found in 20 lease files, and 26 lease files did not contain acceptance reports.

Lease Package Distribution

VHA procedures include a requirement to send a copy of the complete executed lease to the Director, Real Property Program Management Office. Two leases were not submitted.

Succeeding Lease Procedures

A succeeding lease is a new lease designed to allow VA to continue to occupy leased property after the original lease has expired. There were 20 succeeding leases in the 65 leases reviewed. The requirements for a succeeding lease are:

- Advertise, if space exceeds 10,000 square feet
- Prepare a Market Survey
- Either of the following:

If the market survey reveals there are no potentially acceptable locations, prepare a justification for other than full and open competition to support entering into a succeeding lease with the present lessor, or

If there are potentially acceptable locations, negotiate with all interested parties.

Succeeding lease procedures were not followed for 14 leases. Four leases did not have market surveys. Ten leases did not have written justifications for other than open competition.

Accounting for Lease Cost

Account 2330, Real Property Rentals, should be used to record VA lease costs except for costs of GSA space. Lease costs for two leases were charged to the wrong accounts. For a warehouse lease, 9 of 10 payments totaling \$15,975 were incorrectly charged to either the Contracts and Agreements account or a Surgical Service account. For a Vet Center lease, 3 of 12 payments totaling \$6,000 were incorrectly charged to the GSA Vehicles account.

**MONETARY BENEFITS
IN ACCORDANCE WITH IG ACT AMENDMENTS**

Report Title: Audit of Department of Veterans Affairs Leased Space

Project Number: 6R5-036

<u>Recommendation Number</u>	<u>Category/Explanation of Dollar Impact</u>	<u>Better Use of Funds</u>	<u>Questioned Costs</u>
1a	Questioned Cost. Amount VA can recover from another government agency for warehouse lease cost.	\$ -0-	\$ 7,700
1b	Questioned Cost. Amount VA can collect for liquidated damages for the late occupancy.	\$ -0-	\$ 5,948
2	Questioned Cost. Amount VA is paying GSA in excess of current market value for selected leases.	\$ -0-	\$1,627,741
	Better Use of Funds ² . Amount VA will save by canceling unnecessary parking lease.	\$ 6,000	\$ -0-
		<u>\$ 6,000</u>	<u>\$1,641,389</u>

² At our suggestion, the parking space lease was canceled effective December 1, 1996, for an approximate cost savings of \$6,000. Therefore, a recommendation was not made.

MEMORANDUM FROM THE UNDER SECRETARY FOR HEALTH

Department of
Veterans Affairs

Memorandum

Date: SEP 26 1997
From: Under Secretary for Health (10)
Subj: *OIG Draft Report Audit of Department of Veterans Affairs Leased Space*
To: Assistant Inspector General for Auditing (52)

1. VHA program officials have reviewed this report and, with one exception, we agree with the findings and recommendations, as well as with your dollar impact estimations. The audit's positive conclusion that property leasing processes are generally administered economically and effectively supports our own perceptions in this regard.

2. Although we concur in principle with the recommendation that procedures be developed to ensure that GSA rental rates are consistent with current fair market values, we have not yet identified a practical method to achieve this goal that does not demand extensive research and analytical review by staff in Headquarter's Lease Management Service of an enormous amount of real estate data. The Building Owners and Managers Association International (BOMA) report of national rental rate ranges, which you recommended as a resource tool for facility contracting officers in determining equitable lease rates is highly technical and designed for interpretation by realty professionals. The complexity of this document generally negates useful application by most of our facility staff, since few have the required levels of technical expertise in real estate management. As detailed in the accompanying action plan, Lease Management Service is attempting to identify mechanisms to address this issue that are both cost effective and value added. As a preliminary measure, however, we will assure that all VISN Offices and medical facility top managers are fully apprised of identified concerns. Emphasis will be placed on the need for contracting staff to routinely assess, at least on a superficial level, current comparative rates between GSA and community realtors. Leases that appear to qualify for the GSA appeal process will be referred to the Lease Management Service for additional review. At the Headquarters level, consideration will also be given to contacting other federal agencies to determine if similar concerns with GSA rates have been identified. Follow-up discussion with GSA officials to share OIG's findings might also be pursued.

3. Numerous actions have already been initiated to address your other recommendations. The Lease Management Service, in close coordination with attorneys from the Office of General Counsel, will carefully review the specified

MEMORANDUM FROM THE UNDER SECRETARY FOR HEALTH

Page 2 OIG Draft Report: Audit of DVA Leased Space

contract files to determine whether valid options exist for payment reimbursements to VA. When appropriate, negotiations to recover costs will be initiated with involved lessors, with final determinations anticipated by the end of this November.

4. The requirement for a 90-day termination clause in all Vet Center leases has been rescinded and appropriate changes have been reflected in official policy directives to this effect.

5. Lease Management Service recognizes that ongoing training for facility contracting officers in lease administration practices is very beneficial and the Service plans to seek funding for a week-long national seminar which, if funded, will be scheduled during the third quarter of FY 1998. In the meantime, periodic teleconference calls with all VISN/field contracting staff will be scheduled to reinforce existing procedures and to discuss specific issues that have been identified in your report. We additionally note that VHA has no immediate plans to extend leasing authority beyond the existing dollar level of delegated authorities.

6. Thank you for the opportunity to respond to this draft report. If additional assistance is required in the processing of your final document, please contact Paul C. Gibert, Jr., Director, Management Review and Administration, Office of Policy, Planning and Performance, at 273-8355.

(Original signed by Thomas Garthwaite for:)
Kenneth W. Kizer, M.D., M.P.H.

Attachment

MEMORANDUM FROM THE UNDER SECRETARY FOR HEALTH

Action Plan in Response to OIG/GAO/MI Audits/Program Evaluation/Reviews

Name or Report: OIG Draft Report *Audit of Department of Veterans' Affairs
Leased Space*

Report Number: 6R5-036

Date of Report: undated

Recommendations/ Actions	Status	Completion Date
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Recommendation 1

We recommend that the Under Secretary for Health:

- a. Explore options to determine if VA can recover the \$7,700 paid to the other government agency for warehouse space prior to the effective date of the lease.

Concur

VHA's Lease Management Service, in close coordination with attorneys from the General Counsel Office, will thoroughly review this contract file to initially determine the legal potential for successful recovery of the fee. Negotiations with the lessor will be conducted as appropriate and, if a mutually agreeable resolution is not forthcoming, a determination will be made about whether additional legal action is indicated.

In Process

November 30, 1997

- b. Explore options to determine if VA can collect liquidated damages for the late occupancy for lease V612(RE) 91-32.

Concur

The Lease Management Office will assess collection options for this lease in conjunction with their review of the case identified in Recommendation 1a. The same procedures and timelines will be followed.

In Process

November 30, 1997

- c. Eliminate the requirement for 90-day termination clauses in Vet Center leases. Delegate authority to the RCS Regional Directors to include the 90-day termination clause on a case-by-case basis as needed.

Concur

MEMORANDUM FROM THE UNDER SECRETARY FOR HEALTH

Page Two VHA Action Plan/OIG Draft Report: *DVA Leased Space*

This requirement has been eliminated. VHA Directive 7815, *Acquisition of Real Property by Lease and by Assignment from GSA*, which is in the process of final Departmental concurrence, specifically addresses termination issues: "No termination clause will be required. The RCS Regional Manager may include such a clause if it is determined to be in the best interest of veteran care. If this clause is included in the lease, it must have been added at the time the solicitation or specifications for SLAP were formulated."

In Process

September 30, 1997

Recommendation 2

We recommend that the Under Secretary for Health develop procedures to ensure that GSA rental rates are consistent with current fair market values and appeal any rates found to be significantly higher.

Concur in Principle

It is reasonable to assume that it is GSA's responsibility to assure that established GSA rental rates reflect current fair market value, and that federal agency itself claims that such is the case. Although OIG's findings suggest that such is not always the case, few, if any field concerns have been raised about GSA overcharges. Nevertheless, we agree that it might be useful if a mechanism were in place to ensure that if GSA rates are not consistently in line with fair market value, appropriate appeal processes can be initiated by field facilities. However, we have not yet been able to identify a workable method to achieve this oversight that does not require extensive research, computation, analytical review and calculation of an enormous amount of real estate data by staff in our Lease Management Service. Given the effects of VHA downsizing actions, staff are stretched to the limits in fulfilling functional duties, and both costs and anticipated benefits must be carefully weighed before additional responsibilities are added.

You recommend that field staff utilize the BOMA report of national rental rate ranges, as a resource tool in identifying potential out-of-line rental charges. This document is highly technical and designed specifically for interpretation by experienced professionals in the real estate field. The complexity of the document, we believe, would deter any practical use by most of our field contracting officers, since few have extensive expertise in realty management.

Lease Management Service will continue to assess methods that might be useful in providing opportunities for comparing relevant market data with GSA rent

Page Three VHA Action Plan/OIG Draft Report: *DVA Leased Space*

MEMORANDUM FROM THE UNDER SECRETARY FOR HEALTH

data. Preliminary attention will be given to assuring that VISN and field facility staff are made fully aware of issues addressed by OIG. During regularly scheduled teleconference calls, such as the weekly Chief Network Officer call, and other communication routes (i.e., FORUM mailgroups, program office newsletters, VHA directives, etc.), the importance of periodically comparing GSA rates with current community market values will be stressed. Staff will be encouraged not to routinely accept GSA leasing rates without question, but, rather, to make at least rudimentary contacts with local realtors and building management organizations to get a sense of current leasing rates for similar properties. As possible out-of-line GSA charges are identified, follow-up contact with the Lease Management Service will be initiated to further explore whether an appeal process is indicated. As part of their efforts, staff will also contact selected federal agencies that rely heavily on GSA rental properties to determine if similar irregularities in rental charges have also been identified. Findings of your audit might also be shared with GSA representatives in an attempt to better understand their methodologies and to determine if that agency is taking steps to streamline its own processes.

Planned

December 1997 and Ongoing

Recommendation 3

We recommend that the Under Secretary for Health:

- a. Emphasize the need to properly document the lease process through periodic telephone conference calls or additional training as needed.

Concur

Lease Management Service is in the process of requesting funding for a week-long training seminar in lease administration for all field contracting officers. Included throughout the training agenda will be emphasis on all aspects of what constitutes appropriate documentation. If funded, the course is targeted for the third quarter of FY 1998.

In the meantime, periodic conference calls will be held to reinforce already published procedures relating to leasing documentation. The conference calls will be geared primarily for contracting support staff in all of the Network offices, who will share information with their respective field facilities.

Planned

March 1997

MEMORANDUM FROM THE UNDER SECRETARY FOR HEALTH

Page Four VHA Action Plan/OIG Draft Report: *DVA Leased Space*

b. Increase facility leasing authorities on a case-by-case basis only. Delay additional delegations to facilities that do not have senior warrant level contracting officers with lease training and experience until proper training has been accomplished.

Concur

The existing directive is in the process of being extended and no increased facility leasing authorities will be provided. Any lease above the exiting dollar thresholds referred to by OIG will continue to be submitted to the Lease Management Service for approval of authority to negotiate.

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