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From: Director, Los Angeles Audit Operations Division (52LA)

Subj: Memorandum Report, Evaluation of the VA Enhanced-Use Lease Program
(Report No. 00-02773-106)

To: Under Secretary for Health (105E)

1. Introduction. The Office of Inspector General performed an evaluation of the Department of Veterans Affairs (VA) Enhanced-Use Lease (EUL) program. Our objective was to determine whether the EUL program had adequate management oversight and controls to ensure that the program benefited veterans and provided VA fair compensation for the use of VA property.

Public Law (PL) 102-86 enacted August 14, 1991, authorized VA to lease undeveloped or underutilized property for compensation in the form of cash and/or in-kind considerations such as the construction, repair, and maintenance of VA property. The law required EULs to contribute to VA's mission, enhance the use of VA property, and provide VA with fair compensation. VA is required to notify Congress of proposed leases, hold public hearings, and publish EUL proposals in the Federal Register. The law mandated that the Nursing Home Revolving Fund receive 75 percent of EUL revenues and that 25 percent of revenues be distributed to the medical care appropriation of the leasing facility. In November 1999, PL 106-117 revised the EUL program and allowed facilities to retain 100 percent of lease proceeds.

The EUL program currently consists of the following categories of leases:

- Homeless housing leases where veterans receive priority placement.
- Child development center leases where VA employees receive discounted rates or priority placement for their children.
- VA regional office (VARO) collocation leases where regional offices are built on the grounds of VA medical facilities.
- Unique leases where the facility has a "one-of-a-kind" project.
- Leases to shift operating expenses where the leaseholder assumes operating or maintenance expenses to partially reimburse VA for the use of its property.

As of December 1, 2000, the Asset and Enterprise Development Service (AEDS) in VA's Office of Facilities Management had implemented 17 EULs valued at about \$192 million and had 79 EUL proposals in development.

2. Background. On March 9, 1999, VA issued Directive 7415.1, "Financial and Program Policies Regarding Enhanced-Use Leasing Program," to improve management oversight and strengthen controls over the EUL program. The directive outlined the major stages in the development of an EUL: (1) the business plan, (2) notice of designation of property for enhanced-use, (3) notice of intent to execute and award an EUL, and (4) delegation of authority to enter into an EUL. The directive also defined EUL program responsibilities. The AEDS implements and manages the EUL program and VA's Office of the Chief Financial Officer establishes reporting requirements and provides financial oversight for EUL revenues.

VA facilities initiate EUL projects by developing business plans that define the project's scope, associated costs, and return on investment. The facilities then submit the business plans to the AEDS that prepares required EUL notifications and documents, directs studies and reviews, coordinates the development of the EUL with Department offices and activities, and finalizes EUL contracts. The AEDS also forwards the EUL to Department officials, including the Office of General Counsel (OGC), who must concur with each major phase of the EUL's development.

VA's Capital Investment Board (CIB), which is responsible for reviewing and approving significant capital investments, must approve EUL proposals involving consideration in excess of \$4 million. The CIB consists of the Deputy Secretary; the Deputy Under Secretaries for Health, Benefits, and Memorial Affairs; and the Assistant Secretaries for Planning and Analysis, Information Technology, and Financial Management. Finally, the EUL must also be reviewed and approved by the Secretary and the appropriate Under Secretary or Assistant Secretary before the lease is implemented.

3. Scope. We reviewed 5 of the 17 EULs in effect as of December 1, 2000. The five EULs were implemented between August 23, 1993, and December 20, 1999, and represented each of the major EUL program categories - leases to construct housing for the homeless, a child development center, a collocated VARO, and an energy cogeneration plant; and an agreement to lease out a medical center golf course.

We reviewed the five leases with AEDS staff and contacted medical center officials where the leased properties were located to determine the officials' impressions on the effectiveness of their leases. The evaluation was conducted in accordance with generally accepted government auditing standards for staff qualifications, independence, and due professional care; field work standards for

planning, supervision, and evidence; and reporting standards for performance audits.

4. Results of Evaluation. AEDS staff provided effective oversight for the EUL program in compliance with PL 102-86 and VA Directive 7415.1. The AEDS staff had implemented effective processes and procedures to ensure that all Federal and VA reporting and approval requirements were met. In addition, EUL proposals were reviewed and evaluated to ensure that the benefits veterans and VA received from the leases exceeded any costs or risks VA assumed by leasing property.

Enhanced-Use Leases Management Oversight and Controls Were Effective. AEDS staff ensured that proposed EULs contributed to VA's mission and improved services to veterans. Required public hearings, Congressional notifications, and Federal Register announcements were completed. Three EULs were executed prior to the issuance of VA Directive 7415.1 and were not subject to the directive's requirements. Two EULs were executed subsequent to the directive's issuance and met all VA policy requirements. The EULs had business plans, analyses of associated costs and return on investment, and required approvals. AEDS staff also stated that VA's OGC reviewed all EUL proposals and participated in the development of the leases. Accordingly we concluded that management controls were operating properly.

Enhanced-Use Leases Benefited Veterans and VA. The EUL program provided VA with a cost-effective method for obtaining additional resources and assets. We agreed with AEDS' determinations that the five EULs reviewed benefited veterans and that compensation VA received was fair. The following examples demonstrate how the EUL program benefited veterans and VA.

- The Houston VA Medical Center leased 20 acres for 35 years to a developer for the construction of a VA regional office, a parking lot, and a compatible commercial development. In exchange for the lease, the developer built the regional office at a reduced price, constructed the parking lot and assumed its maintenance costs, and gave the medical center cash plus a percentage of the gross revenues from the commercial development. By entering into this EUL, the medical center acquired a collocated VARO for about \$11 million, \$6 million less than the \$17 million Congress had originally appropriated for its construction.
- The John L. McClellan Memorial Hospital leased a 76-acre golf course with an appraised value of \$800,000 to the city of Little Rock for 35 years. In exchange for the lease, the city made course improvements valued at \$60,000; and allowed inpatients free access and provided veterans and VA employees with course discounts valued at \$27,500 per year. By leasing the golf course, the hospital was able to shift annual operation and maintenance costs totaling about \$93,000 to the city of Little Rock.

The Enhanced-Use Lease Program Has Continued To Evolve. On August 16, 2000, the then Acting Secretary approved policy changes to streamline the EUL process and reduce approval time from 23 to 11 months. A new policy is currently being drafted that will allow facilities to develop enhanced-use lease concept plans instead of detailed business plans and to combine the CIB approval and “notice of intent to execute” review processes. The proposed policy change only requires the Secretary to review EULs prior to the submission of the two mandated notifications to Congress and allows delegation of other review requirements to the appropriate Under Secretaries.

5. Conclusion. We determined that the EUL program operated effectively with adequate management oversight. EULs provided VA with a cost-effective way to use undeveloped or underutilized property to generate revenues, defray operating costs, and benefit veterans. However, we may revisit this subject after VA’s policy changes designed to streamline the EUL process are implemented and in operation long enough to fully assess their effectiveness. We appreciate the courtesy and cooperation of VA and medical center staff during this review.

For the Assistant Inspector General for Auditing

(Original signed by:)

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