February 8, 2007

TOM A. SAMRA
VICE PRESIDENT, FACILITIES

SUBJECT: Management Advisory – Sale of the Philadelphia Main Post Office (Report Number CA-MA-07-002)

This report presents the results of our review of the sale of the Philadelphia Main Post Office (Project Number 07YG010CA000). We conducted this review after the General Services Administration (GSA) Office of Inspector General (OIG) contacted us regarding their concerns about the sale of the property. During our review, we found several issues that warrant reporting to you in this management advisory.

Background

The former Philadelphia, Pennsylvania, Processing and Distribution Center (P&DC), located at 2970 Market Street, is a U.S. Postal Service-owned facility constructed in 1935 to serve as the main distribution center for the Philadelphia ZIP Code areas 190-192. The P&DC is located on a 21.2-acre site consisting of four Postal Service-owned facilities. They are the P&DC, the truck terminal annex, the vehicle maintenance facility, and the railway express annex. In addition, an 11.7-acre parking lot is part of the complex.

In December 1999, the Postal Service entered into an agreement with Keating Development Company (Keating) to analyze the Philadelphia properties for potential development and marketability. The agreement was scheduled to expire in December 2001. In February 2001, the agreement was extended until December 2006 because the Postal Service's relocation schedule had been extended.

The University of Pennsylvania was identified as a potential buyer in November 2000. In March 2004, an agreement was reached with the University of Pennsylvania, whose campus was adjacent to 30th Street and the Market area, to acquire the entire Postal Service owned 30th Street complex. The agreement of sale provides for the Postal Service to lease back a total of 223,892 square feet in the former P&DC for retail and main office delivery operations and for parking, district administration, postmaster, and

Inspection Service activities. As part of the agreement, the Postal Service will be able to reconfigure retail functions and relocate carrier operations if the University of Pennsylvania chooses to develop this space in the P&DC. This sale is not scheduled to close until the first quarter of calendar year 2007.

In October 2002, the University of Pennsylvania wrote a memo to Keating that stated in part:

> . . . it would be useful to summarize how the University and Keating Development Company could proceed with a joint acquisition of the Postal Service complex whereby Keating would acquire the 30th Street facility and the University would acquire the remaining postal lands (*sic*) assets.

In November 2002, Keating notified the Postal Service that the Internal Revenue Service (IRS) was interested in the properties. In October 2003, Keating began negotiating with the IRS and GSA on its own (Keating's) behalf. Keating suggested that one of its entities purchase the main post office building when the Postal Service sold the properties to the University of Pennsylvania. As part of the arrangement, Keating would lease the building back to the Postal Service, which would sublease the building to GSA for IRS' use.

Objectives, Scope, and Methodology

The GSA OIG contacted us regarding its concerns about the sale of the Philadelphia property. Based on the issues raised, we interviewed employees of Facilities Realty Asset Management and reviewed documentation concerning the sale.

We conducted this review from April 2006 through February 2007 in accordance with the President's Council on Integrity and Efficiency, *Quality Standards for Inspections*. We discussed our observations and conclusions with management officials and included their comments where appropriate.

Prior Audit Coverage

The U.S. Postal Service OIG has not issued any previous audit reports on this subject. However, in April 2006, the GSA OIG informed us of its concerns about the sale of this property. GSA OIG had been monitoring the sale and leasing plans for the property and believed we should be aware of the circumstances surrounding those plans. On July 11, 2006, the GSA OIG issued a memorandum to the GSA Mid-Atlantic Regional Administrator expressing concerns regarding the sale of the property and subsequent lease arrangements. These concerns included the lack of competition for the lease, the classification of the lease as a capital lease, the lack of documentation made available to GSA concerning the sale of the property, the potential security costs, and the need for contingency plans. GSA OIG will continue to monitor the negotiations of these transactions and will report further, as warranted.

Results

Our review found that the Postal Service did not conduct the sale of the Philadelphia property in compliance with the requirements of the Postal Service Realty Acquisition and Management Handbook (RE-1). The property was not valued according to Postal Service requirements and was not sold on the open market. As a result, the sales price of the property may not adequately represent the property's value. In addition, Keating, the property broker, has multiple business relationships regarding this property with the buyer, GSA, IRS, and the Postal Service. These multiple relationships result in an apparent conflict of interest, so there is no assurance that Keating is acting in the Postal Service's best interests.

RE-1 Requirements Not Met

The Postal Service did not offer the property first to GSA, as required by the RE-1. The Postal Service did not obtain the required appraisal, and the property was not offered to state and local governments or competed on the open market. As a result, the Postal Service has no assurance that it received the best price for the sale of the property.

When disposing of excess property, the RE-1 requires that these procedures be followed.

- The Postal Service must issue an intergovernmental notice.
- The Postal Service must notify the appropriate GSA regional office in writing.
- The Postal Service must request that the appropriate GSA region screen federal agencies and determine whether GSA or any other federal agency is interested in acquiring the property.
- If GSA is not interested in acquiring the property, the Postal Service must obtain an appraisal to establish the market value of the property.
- The Postal Service must offer the property at market value to state and local entities that express interest.
- The Postal Service must advertise the property on the open market.

The Postal Service did not follow these procedures. Postal Service officials told us that they did not issue an intergovernmental notice or any written notice to GSA because they knew that GSA did not have the capital funding necessary to purchase the property. However, in a November 2002 memorandum, Keating notified the Postal Service that IRS was interested in leasing the property through GSA, 4 months before the sales contract was signed with the University of Pennsylvania.

The Postal Service also did not obtain an independent appraisal of the property. No valuation of the property was done before negotiations with the University of Pennsylvania began.

The Postal Service did not offer the property to state and local governments and did not advertise the property for sale on the open market. Without market competition, the Postal Service has no assurance that it received the best, most competitive price for the property.

Recommendations

We recommend the Vice President, Facilities:

1. Require an independent market value appraisal be completed for the Philadelphia property and reevaluate the terms of the sale.

2. Take steps to ensure that all RE-1 requirements are met when disposing of future excess properties.

Management's Comments

Management agreed with recommendations 1 and 2. They had the property appraised, reevaluated the terms of sale, and trained all staff on updated RE-1 requirements.

Evaluation of Management's Comments

Management's actions taken are responsive to recommendations 1 and 2 and should correct the issues identified in the finding.

Real Estate Sale Brokered by Contractor with Apparent Conflict of Interest

Keating is involved in this transaction as the broker for the Postal Service, a buyer of a portion of the property from the University of Pennsylvania, a developer of portions of the property, and a lessor to the Postal Service. These interwoven business partnerships nullify the existence of an arm's-length transaction and create an apparent conflict of interest. The Postal Service cannot be certain that its best interests have been served.

In December 1999, the Postal Service entered into a planning agreement with Keating to analyze the Philadelphia properties for potential development and marketability. The original agreement was scheduled to expire in December 2001. In February 2001, the agreement was extended until December 2006 because the Postal Service relocation schedule had been extended.

In July 2000, the University of Pennsylvania was identified as a potential buyer for the Philadelphia properties, and negotiations between the University of Pennsylvania and the Postal Service began. An October 2002 memorandum from the University of Pennsylvania to Keating stated that a joint acquisition had been discussed. In November 2002, Keating advised the Postal Service that they had been approached by GSA regarding the relocation of certain IRS offices to the main post office building on the Philadelphia property. Postal Service officials said Keating was instructed not to discuss this opportunity with the University of Pennsylvania until after the purchase agreement was complete. In March 2004, a purchase agreement was reached between the Postal Service and the University of Pennsylvania. In March 2004, the Postal Service authorized Keating to begin negotiating an arrangement between Keating and the University of Pennsylvania.

Keating has been brokering an arrangement in which it would immediately purchase the main post office building from the University of Pennsylvania when the Postal Service's Philadelphia properties are sold to the University of Pennsylvania. Keating would then lease the main post office building back to the Postal Service, which would sublease it to GSA. Therefore, Keating has a financial interest in the Philadelphia properties as a broker, purchaser, and lessor. This financial interest began in 2002, when Keating was also representing the Postal Service in negotiating the sale of the properties. Because of Keating's multilayered interests throughout the Postal Service negotiations, the Postal Service cannot be assured that Keating places the Postal Service's interests first when representing them.

Recommendations

We recommend the Vice President, Facilities:

3. Consider Keating's role in these transactions and take steps to mitigate the apparent conflicts of interest that may not be in the Postal Service's best interests.

4. Ensure that all employees of Facilities Realty Asset Management are educated in the appropriate roles of brokers and developers assisting the Postal Service with real estate sales, and the importance of avoiding potential conflicts of interest to protect the best interests of the Postal Service.

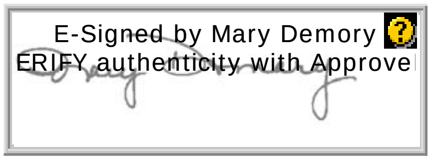
Management's Comments

Management agreed with recommendations 3 and 4. They have considered the apparent conflict of interest and have taken steps to better document Keating's role in these transactions. In addition, they have taken steps to strengthen controls preventing conflicts of interest in the future. All actions should be completed by June 1, 2007.

Evaluation of Management's Comments

Management's actions taken and planned are responsive to recommendations 3 and 4 and should correct the issues identified in the finding.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Judy Leonhardt, Director, Supply Management and Facilities, or me at (703) 248-2100.



Mary W. Demory
Deputy Assistant Inspector General
for Headquarters Operations

Attachment

cc: William Galligan
Deborah A. Kendall

APPENDIX. MANAGEMENT'S COMMENTS

TOM A. SAMRA
VICE PRESIDENT, FACILITIES

UNITED STATES
POSTAL SERVICE

January 25, 2007

MARY W. DEMORY
DEPUTY ASSISTANT INSPECTOR GENERAL
FOR HEADQUARTERS OPERATIONS

Subject: Response to OIG Draft Management Advisory – Sale of the Philadelphia Main Post Office (Report Number CA-MA-07-DRAFT dated December 22, 2006)

The following was taken directly from the OIG Report:

Results

"Our review found that the Postal Service did not conduct the sale of the Philadelphia property in compliance with the requirements of the Postal Service Realty Acquisition and Management Handbook (RE-1). The property was not valued according to Postal Service requirements and was not sold on the open market. As a result, the sales price of the property may not adequately represent the property's value. In addition, Keating, the property broker, has multiple business relationships regarding this property with the buyer, the GSA, the IRS, and the Postal Service. These multiple relationships result in an apparent conflict of interest, so there is no assurance that Keating is acting in the Postal Service's best interests."

Facilities Response

"The Postal Service did not conduct the sale of the Philadelphia property in compliance with the requirements of the Postal Service Realty Acquisition and Management Handbook (RE-1)."

Although Facilities contacted GSA at the time of the sale, Facilities acknowledges that it did not formally document GSA's lack of interest in acquiring the facility. As a result, Facilities has retroactively documented the discussions that took place with GSA via email dated October 17, 2006. GSA responded that they were not interested in purchasing the property then or now. This response from GSA has been provided to the OIG and the OIG acknowledged via email dated January 17, 2007. Facilities will also create a checklist to ensure future adherence to these RE-1 requirements.

"The property was not valued according to Postal Service requirements and was not sold on the open market. As a result, the sales price of the property may not adequately represent the property's value."

Facilities acknowledges that an appraisal was not ordered at the initiation of the sales process in 2001. As a result, Facilities has ordered and received a historic appraisal. The value date of the appraisal is June 1, 2001. This appraisal has been provided to the OIG. The appraisal estimates the market value to be [redacted]. The contract sales price is $50.6 million. In addition, Facilities has updated its RE-1 Handbook to more accurately reflect the legal requirements affecting our property dealings with GSA.

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All Facilities Headquarters and Facilities Service Office (FSO) personnel were trained on the new RE-1 requirements as of the beginning of Fiscal Year 2007. As such, we agree with recommendations 1 and 2, and have taken the corrective action required.

"In addition, Keating, the property broker, has multiple business relationships regarding this property with the buyer, the GSA, the IRS, and the Postal Service. These multiple relationships result in an apparent conflict of interest, so there is no assurance that Keating is acting in the Postal Service's best interests."

We have carefully considered the multiple roles Keating Development Company has assumed in this transaction. The sale of the 30th Street properties by the Postal Service to the University of Pennsylvania (UPenn) is a separate transaction from the potential sale of the MPO building by UPenn to Keating. The business terms of the sale by the Postal Service to UPenn were agreed in principle when the Term Sheet was executed in February 2002, and were agreed upon in final form when the Agreement of Sale was executed in March 2004. The extended negotiations between the Postal Service and UPenn that occurred after execution of the Term Sheet did not alter the purchase price. The discussions between GSA and Keating did not begin until after the purchase price was fixed. Under the potential GSA/Keating/Brandywine transaction, Keating is not the Postal Service's lessor in any real, economic way. The Postal Service will serve as a conduit only for Keating's redevelopment of the space. Furthermore, the proposed Memorandum of Understanding (MOU) to be executed by the Postal Service and GSA, and the leases, which will be incorporated in the MOU, will establish a legal relationship between the parties that leaves no risk for completion of the project on the Postal Service. The proposed GSA/Keating/ Brandywine transaction changes present no financial costs for the Postal Service or legal risks. In fact, the proposed changes represent a significant financial benefit to the Postal Service. The overall benefits that accrue to the Postal Service as a result of the proposed contract change include significant operating expense savings for the administrative office space, carrier and retail space, and parking expenses for all three functions. Additionally the Postal Service will realize a $7.0 million premium from Keating towards the renovation costs of the VMF.

While the sequence of events resulting in the proposed contract change did not create an actual conflict of interest, we concur that more complete documentation of pertinent conversations, and decisions relating to the above noted events would have removed even the appearance of a conflict of interest. We propose to implement new process and procedural changes to address this concern. They include:

- Establishing standard protocols for file documentation to require memorializing pertinent conversations and other relevant activities in order to provide greater transparency to the decision making process.
- Periodic updating of the RAEC committee members regarding transaction issues of concern.
- Requiring approval from RAEC for all significant contract modifications which involve structural changes in projects or present potential conflict issues.

Finally, we propose that the Postal Service Law Department conduct a seminar for Facilities employees in conflicts issues. We believe that these efforts meet the requirements of recommendations 3 and 4. We expect to have implemented our new process and have conducted our conflicts seminars by June 1, 2007.

TASam

Tom A. Samra