June 1, 2010

TOM A. SAMRA
VICE PRESIDENT, FACILITIES

SUBJECT: Audit Report – Facilities Optimization: Controls Over the Selling of Assets (Report Number DA-AR-10-004)

This report presents the results of our audit of the U.S. Postal Service's process for selling real estate assets (Project Number 10YG002DA000). Our objective was to determine if the Postal Service has adequate controls over the selling of real estate assets. We conducted this self-initiated audit based on the operational and financial risks associated with real estate sales. See Appendix A for additional information about this audit.

The Postal Service owns over 9,000 properties nationwide with more than 234 million square feet of space. Congress recognized in the Postal Accountability and Enhancement Act of 2006, that the Postal Service has more facilities than it needs and strongly encouraged streamlining its networks. The Postal Service optimizes its facility network, using several realty asset management methods, including the sale of excess property. Given its current financial condition, it is critical that the Postal Service optimize these sales.

Conclusion

The Postal Service's 41 facility disposal transactions in fiscal years (FYs) 2008 and 2009 resulted in net sales revenue of $275 million for the Postal Service. Thirty of the 41 (73 percent) facility disposal actions taken during fiscal years (FYs) resulted in the "best value"[1] for the Postal Service. However, in 11 of 41 cases, the Postal Service did not obtain best value because internal controls over real estate disposals needed strengthening. In one example, the Postal Service sold and entered into a long-term leaseback agreement for the property instead of consolidating operations in a nearby facility. In other examples, the Postal Service sold properties below book or fair market value.[2]

The Postal Service could have realized an additional $1.7 million in FYs 2008 and 2009, if it had specific guidelines requiring leaseback cost comparisons or governing prospective sales that result in less than the fair market value. In addition, the Postal

[1] Best value is considered to result when the Postal Service maximizes revenue on a sale.
[2] Book value is defined as original cost minus accumulated depreciation. Fair market value is the opinion of property value based on a property appraisal.

Service could have realized another $2.2 million in instances where sales value was not optimized. See Appendix B for our detailed analysis of this topic and Appendix C for an impact summary.

Recommendations

We recommend the vice president, Facilities:

1. Develop updated procedures for the sale of real estate assets. These updated procedures should include, but not be limited to:

    a. Performing a net present value (NPV)/cost benefit comparison of alternatives prior to the sale of real estate assets.

    b. Enhancing procedures that govern "best value" to the Postal Service by designating scenarios and exceptions that may apply in the sale of properties.

Management's Comments

Management agreed with our recommendation and has taken action to enhance facility optimization tools to include net present value comparisons of optimization alternatives. In addition, management recently revised the charter for the Realty Asset Executive Committee to clarify its purpose and strengthen its scope. The intent is to keep the committee focused on the highest risk deals to assure best value for the Postal Service.

While management agreed with the recommendations and the importance of effective internal controls, they disagreed with several aspects of the report including the conclusion that they did not fully achieve best value due to lack of internal controls. They stated that increased internal controls would not have influenced sales when there were extenuating circumstances such as political pressure. As such, they disagreed with the monetary impact presented. We have included management comments, in their entirety, in Appendix G.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the recommendations and management's corrective actions should resolve the issues identified in the report. In reference to internal controls and their ability to minimize risks, we note they also serve as the first line of defense in safeguarding assets and preventing and detecting fraud. In this case, management should design internal controls to prevent or detect unauthorized disposition of Postal Service assets.

The OIG considers all recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Miguel Castillo, director, Engineering and Facilities, or me at 703-248-2100.

E-Signed by Mark Duda
VERIFY authenticity with ApproveIt

Mark Duda
Deputy Assistant Inspector General
for Support Operations

Attachment(s)

cc: Steven J. Forte
Sally K. Haring

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The Postal Service owns over 9,000 properties nationwide. The buildings on these properties total more than 234 million square feet of space. In the Postal Accountability and Enhancement Act of 2006, Congress recognized the Postal Service has more facilities than it needs and strongly encouraged streamlining its networks. According to a recent Government Accountability Office study,[3] although the Postal Service has begun efforts to realign and consolidate some mail processing, retail, and delivery operations, much more is urgently needed.

Realty Asset Management (RAM) is responsible for growing revenue by managing the disposition of real property declared to be excess. In addition, RAM is responsible for assisting the areas and districts with identifying excess property. Specifically, RAM provides internal expertise to identify, analyze, and maximize the return on excess and under-utilized real property assets. Some of the methods RAM uses to manage excess real property include:

- Disposal – selling property
- Outleasing – leasing owned property
- Subleasing/Assignment – reassigning leased property
- Development – investing in real estate projects

Headquarters management and staff are responsible for setting disposal and developmental program direction and goals and developmental program policies and administration, and for obtaining approval from Realty Asset Management Committee for unconventional contracts and agreements. The RAM field organization is responsible for administering disposal and outlease programs nationwide.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to determine if the Postal Service has adequate controls over the selling of real estate assets. To answer the objective, we evaluated 41 real estate sales transactions from FYs 2008 and 2009. We interviewed RAM managers to obtain an understanding of the real estate disposal process and reviewed real estate files for the subject transactions to assess compliance with applicable Postal Service policies. In particular, we assessed compliance with:

- Handbook RE-1, *Postal Service Facilities Guide to Real Property Acquisitions and Related Services,* Chapter 7.

- *Administrative Support Manual* (ASM), Chapter 13, Section 517.[4]

[3] GAO-09-790T, *U.S. Postal Service: Broad Restructuring Needed to Address Deteriorating Finances,* July 30, 2009.
[4] Issued July 13, 1999 and updated through January 1, 2009.

- Facility Service Office Process for Disposal of Excess Property, dated May 2007.

We conducted this performance audit from October 2009 through May 2010 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We discussed our observations and conclusions with management officials on March 25, 2010, and included their comments where appropriate. We did not rely upon computer-generated data during our engagement.

PRIOR AUDIT COVERAGE

The following audit reports are relevant to Postal Service's facility infrastructure:

Report Title	Report Number	Final Report Date	Report Results
Sale of the Old Chicago Main Post Office	SA-WP-09-001	8/25/2009	There are significant risks to the auction of the Old Chicago Main Post Office. Specifically no minimum bid was established and there was no third-party valuation or a review of alternatives and market risks.
Sale of the Philadelphia Main Post Office	CA-MA-07-002	2/8/2007	The Postal Service did not conduct the sale in compliance with the requirements in 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. Management agreed with the recommendations.

APPENDIX B: DETAILED ANALYSIS

Disposal Transactions Generally Obtained Best Value for the Postal Service

Overall, property disposal actions were generally conducted to obtain the best value for the Postal Service. During FYs 2008 and 2009, the Postal Service completed 41 sales transactions, resulting in revenue of $275 million. Twenty-six[5] of the 41 recognized gains totaled $216 million. Of those transactions, the majority were conducted within the stated procedures for asset disposal, allowing them to provide the best financial value for the Postal Service. Notably:

- The 2009 sale of the Tacoma, WA property resulted in a $3,124,250 gain — 1,562 percent over book value.
- The 2009 sale of the El Dorado, AR property resulted in a $1,115,500 gain — 3,281 percent over book value.

See Appendix D for U.S. Postal Service Office of Inspector General comments related to each sale.

Disposal Exceptions

While the Postal Service disposal actions mostly resulted in net gains, we noted 11 instances that did not result in optimum value for the Postal Service. These sales included leasing back property, selling property below book or market value, losing an opportunity to maximize revenue, and accepting a deferred payment plan.

Leaseback

In 2005, the city of Phoenix approached the General Services Administration (GSA) to purchase a building that housed the Postal Service's Downtown Finance Station. The Postal Service rented retail and carrier annex space within the building. In order to expedite the sale, the GSA transferred ownership of the building to the Postal Service to sell to the city. The property was appraised at $1.8 million. Carrier operations were relocated to the Rio Salado facility in 2008. In 2009, the sale was completed for $2 million, resulting in a financial gain of $100,254; however, the Postal Service entered into a long-term leaseback with the buyer.[6]

Research of existing Postal Service facilities in the immediate area showed there are at least eight retail facilities within a 5-mile radius that could absorb the Downtown

[5] Five of the transactions in 2008 and 2009 did not recognize gain or loss on sale.
[6] Lease term is for 5 years fixed, with renewal options for an additional 60 years. This lease may not be terminated during the fixed term, except for cause pursuant to the general conditions or any riders or addendums or other attachments made part of this lease. After the fixed term, the Postal Service may terminate this lease pursuant to this paragraph upon 90 days written notice to the lessor.

Station's retail function. The Postal Service missed the opportunity to consolidate operations rather than leaseback property because RE-1 does not specifically require leaseback cost comparisons for disposal alternatives on a NPV basis.

As presented in Table 1, we determined the cost of consolidating the retail facility would have netted the Postal Service $220,034 and avoided the need for a leaseback. The 5-year lease will cost the Postal Service $48,584 each year.

Table 1. Net Present Value of Fixed Lease Term

Lease Year	0	1	2	3	4
Year	**2010**	**2011**	**2012**	**2013**	**2014**
Labor (160 hours)[7]	$(5,667)	$ -	$ -	$ -	$ -
Material cost[8]+ other One-time expenses	(1,333)	-	-	-	-
Lease cost	48,584	48,584	48,584	48,584	48,584
Total	**$41,584**	**$48,584**	**$48,584**	**$48,584**	**$48,584**
Discounted total	$41,584	$46,941	$45,353	$43,820	$42,338
NPV	**$220,034**				
Hourly rate	$35.42				
Discount rate	.035				

Sales Below Market or Book Value

In FYs 2008 and 2009, the Postal Service sold eight properties either below market value[9] or below book value. For example, in FY 2008, the Postal Service sold the downtown Memphis, TN Post Office to the city of Memphis for $5.4 million – about 78 percent of the appraised value. [redacted]

The remaining seven facilities were sold below book value without any written justification or explanation for the sale. FSO officials indicated the goal to generate immediate revenue drove the sales. In addition, there is no formal guidance or policy that requires financial analysis or written justification for sales made below book value

[7] Labor was estimated for two Postal Service maintenance workers taking 2 weeks to move and set up existing post office boxes and perform possible minor wall build-out.
[8] Material costs and other one-time expenses were estimated at $1,332.80.
[9] The terms "appraised market value," "appraised value," and "market value" are used interchangeably to refer to the value of property estimated by a real estate appraiser.

and tolerance.[10] In these cases, the Postal Service sold the properties for $841,000 less than the book value of $2.3 million. See Appendix E and Appendix F for sale details.

Potential Opportunity Loss on Sale

In 2008, the Postal Service offered the Albuquerque Processing & Distribution Center (P&DC) for sale. The excess property was appraised at $1.2 million, which served as the minimum acceptable bid. The best and final offers received were $1.6, $2.0, and $3.7 million. RAM chose to accept the $3.7 million bid from the city of Albuquerque, NM; however, the city subsequently withdrew the offer. RAM decided to prepare a new Solicitation for Offers (SFO) for $3.5 million but Facilities Headquarters advised them to cancel the SFO and sell it to the city for $2.1 million.

The city's initial offer indicated that the appraisal of the property did not adequately reflect the fair market value. Since the final sale exceeded the appraised value by 71 percent, RAM considered it in the best interest of the Postal Service.

The RE-1 states that efforts must be made to generate adequate market exposure of the property and competition among the interested parties. The broker must also solicit proposals from private properties using public media. However, solicitation and competition is not required for sale to local, state, or government entities. Consequently, there are no definitive guidelines for the offer solicitation and acceptance process when government entities are involved. Because the property was not reoffered at the established market value of $3.5 million, the Postal Service experienced an opportunity loss of $1.4 million.

Sale with Deferred Payment Based on Contingency

In 2008, the Postal Service sold the Farley Building in New York City to the state of New York for $230 million, $55 million of which was deferred, contingent upon building out the common space of the property. The state was to pay $55 million on a pro-rata basis according to the percentage of the area leased. To date, the $55 million future payment is still outstanding and the new owners (the state of New York) have not selected a developer for the project. [11] In its analysis of the sale, public accounting firm Ernst &Young identified the deferred amount as "at risk."

There are no formal guidelines governing the structure of a sale with deferred payments. Lack of formal guidelines for structuring sales can lead to the Postal Service entering sales contracts that do not obtain optimum value.

[10] RE-1, *Implementation Manual*, Chapter 7, requires the report of sales below book value only in cases where the market appraisal is greater than $1 million below book value.
[11] The Postal Service has received an additional $20 million due to inflation and other factors, totaling $195 million.

APPENDIX C: IMPACT SUMMARY

Monetary Impacts

Finding	Impact Category	Amount
Leaseback Issues	Unrecoverable Questioned Costs[12]	$220,034
Sales Below FMV	Unrecoverable Revenue Loss[13]	1,500,000
	TOTAL	**$1,720,034**

Non-Monetary Impacts

Finding	Impact Category	Amount
Opportunity Loss on Sale	Revenue at Risk[14]	$1,400,000
Sale Below Book Value	Revenue at Risk[15]	841,000
	TOTAL	**$2,241,000**[16]

TOTAL IMPACT **$3,961,034**

[12] Unrecoverable costs that are unnecessary, unreasonable or an alleged violation of law or regulation.
[13] Revenue that should have been recognized for goods delivered or services rendered, but were not due to the passage of time or other circumstances.
[14] Revenue that the Postal Service is at risk of losing (for example, when a mailer seeks alternative solutions for services currently provided by the Postal Service).
[15] These types of prospective sales can be categorized as “Revenue that the Postal Service is at risk of losing.”
[16] The $55 million “at risk” from the Sale with Deferred Payment was not included in non-monetary impact because a prior Ernst & Young review of the sale identified this value.

APPENDIX D: FY 2008 REAL PROPERTY SALES TRANSACTIONS

Count	Area	City	Net Sales Revenue	OIG Sales Comment
1	Headquarters	New York, NY	$195,000,000	Sold at gain, but with deferred payment based on contingency*
2	Pacific	San Francisco, CA	7,500,000	No gain/loss recognized
3	Southeast	Memphis, TN	5,400,000	Sold at gain, but below FMV*
4	Southwest	Oklahoma City, OK	3,675,000	Sold at gain
5	Southwest	Albuquerque, NM	2,100,000	Sold at gain, but with opportunity loss of $1.4 million*
6	Southeast	Hollywood, FL	1,818,900	Sold at gain
7	Southwest	Fort Worth, TX	1,735,647	Sold at gain
8	Pacific	Citrus Heights, CA	970,000	Sold at gain
9	Northeast	Branford, CT	850,000	Sold at gain
10	Northeast	Saratoga Springs, NY	608,000	Sold at gain
11	Western	South Lake Tahoe, CA	375,000	Sold at gain
12	Southwest	San Antonio, TX	327,000	Sold at loss with no justification*
13	Eastern	Lexington, KY	200,000	Sold at gain
14	Western	Cameron, MO	90,000	Sold at gain
			$220,649,547	

***Instances that did not result in optimum value for the Postal Service.**

APPENDIX E: FY 2009 REAL PROPERTY SALES TRANSACTIONS

Count	Area	City	Net Sales Revenue	OIG Sales Comment
1	Western	St. Paul, MN	$14,843,750	No gain/loss recognized
2	Northeast	Boston, MA	9,750,000	No gain/loss recognized
3	Eastern	Washington, DC	9,460,205	No gain/loss recognized
4	Western	Tacoma, WA	3,339,250	Sold at gain
5	Eastern	Pittsburgh, PA	2,835,000	Sold at gain
6	Western	Phoenix, AZ	2,000,000	Sold at gain, but with subsequent leaseback*
7	Northeast	Portland, ME	1,915,000	Sold at loss
8	Pacific	Saratoga, CA	1,520,000	Sold at gain
9	Eastern	Virginia Beach, VA	1,388,375	Sold at gain
10	Southwest	El Dorado, AR	1,149,500	Sold at gain
11	Eastern	Cincinnati, OH	1,014,500	Sold at gain
12	Pacific	San Francisco, CA	985,000	No gain/loss recognized
13	Northeast	Parsippany, NY	912,000	Sold at gain
14	Southeast	LaVergne, TN	572,100	Sold at gain
15	Pacific	Danville, CA	504,450	Sold at gain
16	Pacific	Bell, CA	450,000	Sold at loss
17	Northeast	Meriden, CT	448,106	Sold at loss with no justification*
18	Southeast	Clarksville, TN	381,000	Sold at gain
19	Pacific	Moreno Valley, CA	380,000	Sold at loss with no justification*
20	Northeast	Jersey City, NJ	201,360	Sold at gain
21	Southeast	Tamiami, FL	180,000	Sold at gain
22	Northeast	Marlboro, NY	137,618	Sold at loss
23	Southwest	Angleton, TX	102,949	Sold at loss with no justification*
24	Western	Jerome, ID	100,000	Sold at loss with no justification*
25	Western	Fort Dodge, IA	32,775	Sold at loss with no justification*
26	Southwest	El Paso, TX	27,160	Sold at loss with no justification*
27	Northeast	Calais, ME	4,700	Sold at gain
			$54,634,798	

***Instances that did not result in optimum value for the Postal Service.**

APPENDIX F: SALES BELOW BOOK VALUE

Count	Area	City	Appraised Value	Book Value	Sale Price	Loss
1	Northeast	Meriden, CT	$690,000	$798,476	$485,000	$313,476
2	Pacific	Moreno Valley, CA	$230,000	$440,249	$400,000	$40,249
3	Southwest	San Antonio, TX	$310,000	$579,397	$327,000	$252,397
4	Southwest	Angleton, TX	$120,000	$120,909	$110,000	$10,909
5	Western	Jerome, ID	$100,000	$300,000	$100,000	$200,000
6	Western	Fort Dodge, IA	$33,600	$45,836	$34,400	$11,396
7	Southwest	El Paso, TX	$ 27,560	$39,824	$27,360	$12,464
				$2,324,691	**$1,483,760**	**$840,891**

APPENDIX G: MANAGEMENT'S COMMENTS

UNITED STATES
POSTAL SERVICE

May 26, 2010

LUCINE WILLIS
DIRECTOR, AUDIT OPERATIONS
OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Facilities Optimization: Controls Over the Selling of Assets
Report Number DA-AR-10-DRAFT

Thank you for the opportunity to review and comment on the subject draft audit report.

We agree it is important to have effective internal controls over real estate disposals. We have placed strong emphasis on having standardized policies and processes in place, while continually evaluating and implementing improvements. We do disagree, however, with several specific aspects of this report.

The title of this report is Facilities Optimization: Controls Over the Selling of Assets. It should be noted that 39 of the 41 disposals audited were not identified through the current optimization process. The other two, Tacoma and Virginia Beach, were identified in your report as sold at gain. Most of the 39 were the result of Decision Analysis Reports (DARs) for replacement buildings, unsolicited offers from state and local governments, or other targets of opportunity for development.

We are pleased with your finding that out of $275M in revenue generated, only 11 projects are in question that represent $3.9M. We disagree though with your conclusion that best value was not realized because internal controls needed strengthening. Likewise, we disagree with the monetary findings. Below is feedback on the 11 disposals in question:

Leaseback
Consolidation was realized at Phoenix Downtown Station by relocating the carriers to the Rio Salado facility, but current policy does not allow closing of retail facilities for economic reasons. Relocation of retail was considered; however, an Arizona Congressman had a bill passed, requiring by law that the Post Office remain in this historic building. The final solution was to downsize retail from six service counters to two. Overall, by consolidating the carriers and downsizing retail, leased space reduced from approximately 17K square feet to approximately 6K square feet. The Postal Service was able to reduce the amount paid for rent, generated $100K on the sales transaction and secured long term security for the retail operation.

Sales Below Market or Book Value
Your report states that in fiscal years (FY) 2008 and 2009, the Postal Service sold eight properties either below market value or book value. Regarding properties sold for less than appraised value, Memphis Front Street was a highly charged, political project. We were under considerable pressure from the University of Memphis and the Senator from Tennessee to sell the building. Increased controls would have had no impact on the sale as it was strictly politically driven.

Meriden was a vacant three-story building, built in 1910. The building was on the market for over two years. Downtown Meriden was in a state of decline and vandalism was a significant issue. The city expressed interest in the building for $200K. The accuracy of the appraisal was questioned, but it was determined we were fortunate to have a buyer and that expediency was in the best interest of the Postal Service in order to avoid further maintenance costs. This was a business decision and increased controls would have had no impact on the sale.

Angleton, Texas and El Paso, Texas were sold for $10K and $200 less than appraised value respectively. This is well within current policy requiring sales to meet or exceed 90 percent of appraised value and no further approval was required.

The report also states that seven facilities, including Meriden, Angleton, and El Paso were sold below book value. Postal policy is to sell excess properties at 90 percent of appraisal or higher. Book value does not represent current market value. Book value is an accounting matter to be managed by Finance.

Potential Opportunity Loss on Sale
The appraised value of the Albuquerque P&DC property was $1.2M. We do not agree that the market value was re-established at $3.5M because the city offered $3.7M during the Solicitations for Offers process. That offer was withdrawn and an agreement was ultimately reached with the city for $2.1M. The $3.7M offer was clearly an outlier when compared to the appraisal and other offers. The $2.1M final price is 71 percent over appraisal and higher than any of the other offers. It is unlikely increased controls would have had a major impact on the final outcome.

Sale with Deferred Payment Based on Contingency
The $55M contingency for the Farley Building in New York City is not a deferred payment and as a result can not be considered at risk. The Postal Service sold the building for a value determined to be appropriate value at that time. The $55M represents a Postal gain share, if the State of New York redevelops over and beyond what was envisioned at the time of the sale. This is an excellent situation for the Postal Service because revenue continues to be generated as the value of the building increases. Checks and balances are that all disposals with potential deferred payments must be reviewed by the Realty Asset Executive Committee and recommended for approval of the Vice President, Facilities.

Recommendation 1.a.
Develop updated procedures for the sale of real estate assets. These updated procedures should include, but not be limited to performing a net present value /cost benefit comparison of alternatives prior to the sale of real estate assets.

Response
Management agrees with the recommendation.

Facility optimization tools and processes have been greatly enhanced. Utilizing on-line tools, Facilities planners are able to effectively evaluate excess space and consolidation alternatives. The standard node study format requires an net present value/cost benefit comparison of alternatives. A recently completed standard optimization and disposal flowchart has been transmitted to all planners and real estate specialists involved in property disposals.

Recommendation 1.b.
Develop updated procedures for the sale of real estate assets. These updated procedures should include, but not be limited to enhancing procedures that govern "best value" to the Postal Service by designating scenarios and exceptions that may apply in the sale of properties.

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Response
Management agrees with the recommendation.

The Realty Asset Executive Committee is a cross functional group established to advise the Vice President, Facilities on best value decisions related to developmental and non-standard disposals. This committee meets once a month. The charter was recently revised to clarify purpose and strengthen scope definition and submittal processes. The intent is to keep the committee focused on highest risk deals to assure that Postal Service's interests are protected and best value is achieved.

We do not believe that this report contains any propriety or business information and may be disclosed pursuant to the Freedom of Information Act.

Tom A. Samra

cc: Steven Forte
Sally Haring
Kathy Banks