July 12, 2011

JOSEPH CORBETT
CHIEF FINANCIAL OFFICER AND EXECUTIVE VICE PRESIDENT

MARIE THERESE DOMINGUEZ
VICE PRESIDENT, GOVERNMENT RELATIONS AND PUBLIC POLICY

SUBJECT: Management Advisory – Leveraging Assets to Address Financial Obligations (Report Number FF-MA-11-118)

In recent U.S. Postal Service Office of Inspector General (OIG) reports, we identified more than $142 billion the U.S. Postal Service has made in overpayments to its retirement benefits programs.[1] The Office of Personnel Management (OPM) used an improper funding allocation methodology for the Civil Service Retirement System (CSRS) and excessive health care inflation rates. We also reported the Postal Service has prefunded its pension and retiree health benefits plans at substantially higher levels than other public and private sector entities. According to figures the OPM provided, the Postal Service has already funded nearly 85 percent of those future obligations.[2] Further, the Postal Service continues to pay about $11 billion annually to fund these retirement programs.[3]

The Postal Service is currently working with Congress to develop legislation to address comprehensive issues identified in our prior audit reports. In the interim, this report presents the results of our review to determine whether an opportunity exists for the Postal Service to leverage the substantial wealth it holds in assets (building and land) to address its annual mandatory funding obligations (Project Number 11BD008FF000). See Appendix A for additional information about this review.

[1] The OIG issued five management advisory reports and one white paper addressing overpayments related to pensions and retiree health care. See Appendix A for a list of the reports.
[2] As of September 30, 2009, OPM estimated the Postal Service's future retirement costs totaled $363.9 billion, while assets to cover these liabilities totaled $309.1 billion, leaving an unfunded liability of $55 billion.
[3] The Postal Service pays about $3 billion annually to fund the Federal Employees Retirement System (FERS), $5.6 billion annually through FY 2016 for the mandatory Postal Accountability and Enhancement Act (Postal Act) of 2006 payments to the retiree health fund, and more than $2 billion annually for current retiree health care premiums. The Postal Act of 2006 suspended funding CSRS by the Postal Service until FY 2017.

Leveraging Assets for Retirement Benefit Obligations

The Postal Service has the authority to transfer its real property to other government agencies with or without reimbursement when the transfer would serve the public interest.[4] Therefore, the Postal Service could leverage its real property assets with the consent of the U.S. Department of Treasury (Treasury) and OPM under terms and conditions to which all parties agree.[5] The Postal Service would retain title to the leveraged properties unless or until it is no longer able to fund its retirement programs at an operational level. If the Postal Service becomes insolvent, Treasury could liquidate the leveraged real property and return the programs to an operational level.

The Postal Service reported nearly $27 billion (purchase price) for property such as buildings and land in its fiscal year (FY) 2010 annual financial report.[6] The fair market value of these assets (owned by the Postal Service) is likely to be much higher than the purchase price of the assets, as some of these holdings were purchased in prime locations years ago and their market value may have appreciated considerably.[7] To determine the fair market value of Postal Service-owned real property, many factors must be considered, such as region, square footage, location, traffic flow, and facility type. Nevertheless, if the Postal Service were to leverage its real property assets at the fair market value, that amount would likely cover the remaining $55 billion of unfunded liability in its retiree benefit funds. For example, the National Postal Museum had a purchase price of $47 million and an assessed tax value of $304 million (as shown in Illustration 1).[8]

[4] 39 U.S. Code (U.S.C.) § 2002(d) (1970).
[5] 39 U.S.C. § 401(5) and 411.
[6] The Postal Service does not maintain fair market or assessed tax value records for its properties.
[7] An estimate of the fair market value of Postal Service property and equipment was outside the scope of this report.
[8] We obtained the assessed value from area taxing authority records.

Illustration 1: National Postal Museum, Washington, D.C.

Source: http://newsdesk.si.edu/sites/default/files/photos/building_5.jpg

Although this example may not represent the average appreciation of property, the Postal Service is likely to have a significant cumulative base of appreciation from which to leverage its buildings and land, because it owns properties in every major U.S. city. For other examples of purchase price vs. assessed values for Postal Service-owned real property, see Appendix B.

The Postal Service has the authority to sell, maintain, lease, or dispose of its real property in any manner it deems necessary or convenient.[9] It has used this authority since its creation under the Postal Reorganization Act of 1970. The Postal Service's ability to leverage assets to address financial obligations is contingent on the Treasury and OPM's acknowledgment that it could use real estate, if necessary, to fund its retirement programs. Hence, the Postal Service, Treasury, and OPM would need to define and agree to the terms and conditions to facilitate such an arrangement. The parties would also need to agree on the fair market value of each Postal Service property to be leveraged before executing such an arrangement.

Further, leveraging assets does not necessarily count against the debt ceiling. This is important, because the Postal Service expects to reach its $15 billion debt ceiling by the end of FY 2011. The Postal Service projects it will not have sufficient cash and borrowing capacity to fund fully retirement benefit obligations due on September 30, 2011.[10]

[9] 39 U.S.C. § 401(5).

[10] The Postal Service has an estimated $5.5 billion payment due to its Retiree Health Benefit Fund on September 30, 2011.

Although current legislation provides the Postal Service the authority to sell, maintain, lease, or dispose its real property in any manner it deems necessary or convenient, we do not believe this option has been fully explored. Consequently, the Postal Service has not developed processes to use assets in this manner. We believe the Postal Service should coordinate with applicable parties to identify specific properties that it plans to hold (and, in the case of default, convert to cash), and that group of properties would need to be individually appraised to identify the fair market value of the property. The process should allow the Postal Service the authority to substitute properties if it determines to close one of the leveraged facilities.

The Postal Service has accumulated about $309 billion in cash for its retirement benefit funds. To achieve 100 percent funding of its retirement benefit programs, the Postal Service needs an additional $55 billion in cash or assets. The Postal Service owns buildings and land having a purchase value of $27 billion.[11] We believe if the real property were appraised at its fair market value, the value of assets would likely exceed the current $55 billion needed to fully fund the retirement programs. This would protect taxpayers, and a surplus of assets would likely be given to the Treasury if the Postal Service were suddenly shut down – a very unlikely event. Further, leveraging the substantial wealth the Postal Service holds in real property assets would assist it in meeting current operational needs without increasing debt.

We recommend the chief financial officer and executive vice president, in coordination with the vice president, Government Relations and Public Policy:

1. Coordinate with applicable parties, such as Congress, the Office of Personnel Management, and the U.S. Department of Treasury, to leverage Postal Service property, at the fair market value, to achieve 100 percent funding for its retirement benefit programs.

Management's Comments

Overall, management agreed with the intent of the recommendation and considers the value of Postal Service property assets relevant when considering the unfunded retirement obligations. However, management does not know whether property assets can be used to achieve 100 percent funding of these obligations in any legal or actuarial sense if the Postal Service retains the title of the property. Upon sharing this report with Treasury's policy staff, the Postal Service and the Treasury believe further analysis is needed to demonstrate the feasibility of our recommendation. In addition, the Postal Service already identifies assets that are in excess of needs and obtains best value from either development or disposal of those assets. The Postal Service also noted that, in the short term, it believes the best legislative course would be for the rescission of the mandate to pay more than $5 billion annually into the Retiree Health Benefit Fund, return of the FERS overfunding, transfer of the CSRS surplus to the Retiree Health

[11] As of December 2010, the Postal Service owned nearly 8,900 buildings and parcels of land.

Benefit Fund, and other initiatives. Management will raise the leveraging issue with other stakeholders, as appropriate. See Appendix C for management's comments, in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendation, and management's corrective actions should resolve the issue identified in the report.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact William Rickett, acting director, Field Financial – Central, or me at 703-248-2100.

John E. Cihota
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Attachments

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Appendix A: Additional Information

BACKGROUND

The Postal Service is currently facing severe fiscal challenges. Declining mail volume coupled with the burden of attempting to prefund future retirees' health care as required by the Postal Act of 2006 have placed the Postal Service in a precarious financial position. It must overcome tremendous challenges to remain financially sound and meet its mission. Because the Postal Service is such a large employer with substantial retirement benefits, obligations such as prefunding its pension and retiree health benefit liabilities poses a significant challenge.[12] The Postal Service has prefunded its retirees' pension obligations at close to 100 percent of the OPM's actuarially estimated liabilities. For its retirees' health care, the Postal Service is increasing its prefunding level. This increase is a result of the Postal Act of 2006's requirements to prefund retirees' health care at about $5.6 billion per fiscal year from 2007 through 2016.

There is little debate for requiring the Postal Service, or any entity, to fund its retirement benefit programs. However, there is no statute governing public sector pension plans or retiree health benefits that defines "prefunding". The prefunding levels established for the Postal Service are the result of the OPM setting funding requirements for the CSRS and FERS pension plans, the Postal Act of 2006's funding requirements for Postal Service retirees' health care, and requirements to pay current retiree health care premiums. The prefunding requirements will force the Postal Service eventually to prefund all retirement benefit programs at or above 100 percent. These payments have contributed significantly to the Postal Service's dire financial condition. According to the postmaster general, in the past, the Postal Service paid this obligation using extra funds and borrowing authority. As a result, the Postal Service projects it will not have sufficient cash to meet obligations by the end of FY 2011.

One significant purpose of fully funding future retirement benefits is to reduce the risk of the Postal Service being unable to pay those benefits to current and future retirees when earned due to default or dissolution of the Postal Service. However, these funding requirements do not account for significant overpayments in retirement benefit funds[13] or the value of assets, such as real property, owned by the Postal Service.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this management advisory was to determine whether an opportunity exists for the Postal Service to leverage its assets to reduce its financial liability. We obtained information from real estate industry personnel and Postal Service officials to prepare this report. We also obtained assessed property values from taxing authorities

[12] Pensions consist of the CSRS and the FERS.

[13] As noted in *Summary of Substantial Overfunding in Postal Service Pension and Retiree Health Care Funds* (Report Number FT-MA-10-002, dated September 30, 2010), the Postal Service has overfunded both its CSRS and FERS pension obligations.

and property photographs from various Internet websites. We did not rely on computer-generated data to support the opinions and conclusions presented in this report.

We conducted this review from December 2010 through July 2011 in accordance with the Council of the Inspectors General on Integrity and Efficiency, *Quality Standards for Inspection and Evaluation*. We discussed our observations and conclusions with management on May 11, 2011, and included their comments where appropriate.

PRIOR AUDIT COVERAGE

We issued the following reports addressing opportunities for recovering overfunded amounts related to employee and retiree benefits. Management generally agreed with our recommendations that included seeking financial relief.

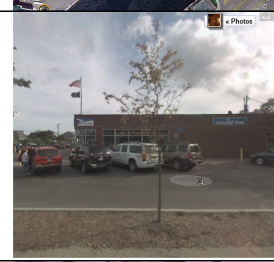
Report Title	Report Number	Final Report Date	Monetary Impact	Report Results
Management Advisory – Substantial Savings Available by Prefunding Pensions and Retirees' Health Care at Benchmarked Levels	FT-MA-11-001	11/23/2010	$59.8 billion	This report summarizes the results of our review and benchmarking of the Postal Service's prefunding of pensions and retiree health care liabilities. It recommends management pursue necessary changes that would permit the Postal Service to prefund pension and retiree health care funds to benchmarked levels of 80 and 30 percent, respectively, of liabilities.
Summary of Substantial Overfunding in Postal Service Pension and Retiree Health Care Funds	FT-MA-10-002	9/30/2010	$8.7 billion	This report summarizes the results of four OIG reports identifying overfunding issues in employee and retiree benefit funds. It recommends management develop a comprehensive legislative strategy to recover overfunded amounts and review all available data related to pensions and retiree health benefit calculations to ensure that calculations are reasonable and accurate.

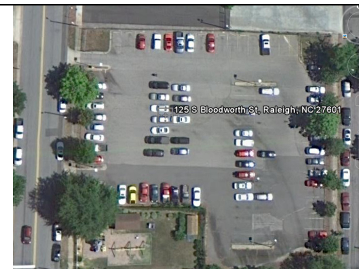
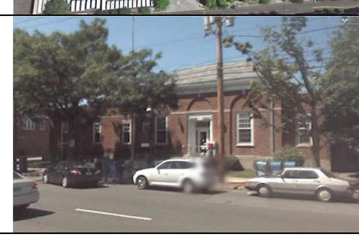
Report Title	Report Number	Final Report Date	Monetary Impact	Report Results
Federal Employees Retirement System Overfunding	FT-MA-10-001	8/16/2010	$0	This report identifies that the Postal Service overfunded its FERS contributions by $5.5 billion. In addition, present legislation does not exist to resolve surpluses. Further, it recommends that the Postal Service's pension responsibilities be clearly delineated and separated from those of the rest of the federal government.
Civil Service Retirement System Overpayment by the Postal Service	CI-MA-10-001	6/18/2010	$49.8 billion	The report discusses the $75 billion CSRS overfunding by the Postal Service, assesses the related facts, and identifies solutions.
The Postal Service's Share of CSRS Pension Responsibility	RARC-WP-10-001	1/20/2010	$0	This report discusses the inequities of the current system of funding of the Postal Service's CSRS pension responsibility and explains that it has resulted in an overfunding of $75 billion.
Estimates of Postal Service Liability for Retiree Health Care Benefits	ESS-MA-09-001(R)	7/22/2009	$5.95 billion	This report questions the OPM's assumption that the annual health care cost inflation rate will average 7 percent annually for all future years.

Appendix B: Examples of Postal Service-Owned Real Property

Table 1 provides examples of real estate owned by the Postal Service with applicable purchase prices and assessed values. We judgmentally selected these sites based on geography and the availability of the assessed value provided by local taxing authorities. These assessments may not represent fair market value, but we used this data because we were unable to obtain fair market value appraisal information for Postal Service-owned properties. The Postal Service only obtains this information when the property is appraised at the time of purchase.

Table 1: Purchase Price Versus Assessed Value for Selected Real Estate

Facility Type and Location	Purchase Price	Assessed Value	Illustration
Processing and Distribution Center (P&DC) 25 Dorchester Avenue, Boston, MA	$129,145,751	$177,851,323	
Main Office 9 Lagoon Pond Vineyard, MA	$1,640,338	$3,006,800	
Main Office 400 Whitehead Street Key West, FL	$4,804,679	$15,159,124	
Elway Station 1715 7th Street West Saint Paul, MN	$138,030	$1,175,600	
Postal Service Headquarters 475 L'Enfant Plaza Washington, DC	$75,679,774	$115,167,700	

Facility Type and Location	Purchase Price	Assessed Value	Illustration
P&DC Parking 125 South Bloodworth Street Raleigh, NC	$420,506	$646,020	
Vehicle Maintenance Facility/Parking Garage 2460 4th Avenue South Seattle, WA	$13,448,230	$25,272,100	
Southmore Station 4100 Almeda Road Houston, TX	$5,032,314	$17,486,466	
P&DC 715 NW Hoyt Street Portland, OR	$36,998,582	$43,524,480	
Main Office 1262 Post Road Fairfield, CT	$1,074,531	$3,426,080	

Source: We obtained location data and purchase values from the Postal Service, assessed values from local taxing authorities, and photographs from various Internet websites.

APPENDIX C: Management's Comments

UNITED STATES POSTAL SERVICE

July 5, 2011

SHIRIAN HOLLAND
ACTING DIRECTOR, AUDIT OPERATIONS

SUBJECT: Leveraging Assets to Address Financial Obligations (Report Number FF-MA-11-DRAFT)

The report recommends that we should "coordinate" with the Department of the Treasury and the Office of Personnel Management (OPM) "to leverage Postal Service property, at the fair market value, to achieve 100 percent funding for its retirement benefit programs," acknowledging that the Department of the Treasury and OPM must consent to this process. As a general proposition, the United States Postal Service believes that, if such an action is deemed necessary, the government could seize and liquidate the Postal Service's property in order to ensure that funds are available to pay retirement benefits. In this general sense, we agree that the value of Postal Service property assets is relevant when considering the Postal Service's unfunded retirement obligations. However, it is much less clear whether our property assets can be used "to achieve 100 percent funding" of those obligations in any legal or actuarial sense when, as indicated in the report, the Postal Service would retain title to the property.

Recommendation 1:
Coordinate with applicable parties, such as Congress, the Office of Personnel Management, and the U.S. Department of Treasury, to leverage Postal Service property, at the fair market value, to achieve 100 percent funding for its retirement benefit programs.

Management Response/Action Plan:

The Postal Service has complied with the report's recommendation and shared the draft report with Treasury's policy staff, whose initial reaction was to raise questions as to whether pledging real estate assets as collateral meets the legal requirements for funding retirement benefits, and felt this legal question needs to be researched before conducting other policy analysis or pursuing specific recommendations. They also had questions about the operational feasibility of such a funding mechanism for retiree benefits. Treasury staff believes that prior to further consideration of the proposal in the draft report, an analysis will have to be provided to them demonstrating that it meets all operational and legal requirements. Finance and Government Relations will continue to raise the recommendation when appropriate circumstances arise so that perhaps the political headwinds will result in a solution. At present, our General Counsel has not determined a legal basis for implementing your suggestion.

Additionally, the report acknowledges that the Postal Service already has the authority under current legislation to "sell, maintain, lease, or dispose of its real property in any manner it deems necessary or convenient." With respect to its real estate holdings, the Postal Service already engages in identifying assets that are in excess of needs and obtaining best value from either

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development of those assets or disposal. The Postal Service has been in the process of selling excess assets in order to generate cash and will continue to do so consistent with operational needs and other business considerations. We have just entered into a contract which enlists services of a national real estate management firm to assist in our efforts to drive revenue from sales of real estate and reduce expense.

The report indicates that the "Postal Service has prefunded its pension and retiree health benefits plans at substantially higher levels than other public and private sector entities," and that the Postal Service is working with Congress to develop legislation to address the comprehensive issues surrounding the overfunding of both the Civil Service Retirement System (CSRS) and the Federal Employee Retirement Systems (FERS) retirement benefits programs. In the short-term, the Postal Service believes that the best legislative course of action would be for the rescission of the legislative requirement to pay $5.5 billion into the Postal Service Retiree Health Benefit Fund (PSRHBF), the return of overfunding for the FERS obligation, transfer of the Postal Service's CSRS surplus to the PSRHBF, and other legislative initiatives currently being pursued, such as six- to five-day delivery.

Target Implementation Date:

As appropriate the Postal Service will raise the issue with other stakeholders. There is no target implementation date.

Responsible Official:

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