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Washington, DC 20548

Logistics and
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Division

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The Honorable Joel W. Solomon
Administrator of General Services

Dear Mr. Solomon:

As part of our review of the management of the General Services Administration's (GSA's) alteration and major repairs program, we examined the economic analysis supporting your Agency's prospectus to renovate the U.S. Customhouse at 1 Bowling Green, New York, N.Y. The proposed renovation, at a cost of $24.7 million, would permit the U.S. Customhouse to be used as office space for Federal agencies and at the same time preserve it as an historical landmark. The prospectus for the project was approved by the Office of Management and Budget on May 15, 1978, and the Senate Committee on Environment and Public Works on August 16, 1978. It is still under consideration by the House Committee on Public Works and Transportation.

We are bringing to your attention significant errors and omissions in the economic analysis supporting that prospectus.

THE NEW YORK CUSTOMHOUSE

The Customhouse was built in 1907, is on the National Register of Historic Places, and comes under New York City landmark regulations. As a registered historical structure, it is subject to certain legal and administrative restrictions regarding its preservation and restoration.

Consequently, there are unique factors to be considered by GSA and the Public Works Committees in weighing the alternatives of renovating the building, constructing a new building to meet the same space needs, or leasing an equivalent amount of space. There is also the unresolved question of whether: (1) the property can be sold with its historical preservation restrictions, and at what price or (2) it must be retained by the Government, and if so, at what cost to prevent vandalism and further deterioration.

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Another point to be considered is the intent of the Congress regarding the renovation and use of historical structures under the Public Buildings Cooperative Use Act of 1976. The act directs the Administrator of General Services to consider historically, architecturally, or culturally significant buildings as an alternative for meeting the space needs of the Government. We believe the act should be clarified as to whether or not the renovation of a historical structure must be justified as preferable to other alternatives for housing Government activities, or judged solely on its own merits. We pointed this out to the Chairmen of the Public Works Committees in a report dated January 25, 1979 (LCD-79-302).

ECONOMIC ANALYSIS

Both Office of Management and Budget Circular A-104 and GSA policy require that an economic analysis be performed to determine the least costly method of meeting office space requirements. Accordingly, before submitting the prospectus for the U.S. Customhouse renovation project, GSA compared the costs of renovation to the costs of two alternative ways of providing Federal office space in New York City--the construction of a new building and the leasing of office space (see enclosure).

The GSA analysis indicated that renovation was the least costly alternative and the results of this analysis were used in the prospectus sent forward for approval to the Office of Management and Budget and the Congressional Public Works Committees. The analysis was done by GSA's Repair and Alteration Division based on the procedures and guidelines included in the revised GSA Handbook for the Repair and Alteration Program issued August 1, 1978.

The first step in an economic analysis is identifying all cost categories associated with each alternative during its economic life. The second step is estimating the magnitude of each cost category and the time in which the costs, or a part of the costs, for each category will be incurred for each alternative. After the cost elements for the various alternatives are estimated for the year incurred, they are converted to their present values to reflect the time value of money. The present value cost is the amount of money that would have to be invested at the present time in order to provide enough funds to pay all the costs of the alternative during its lifetime. After the costs of each alternative have been converted into their present value costs, they can be compared; the alternative with the lower present value costs can be identified as the economically preferable choice.

DEFICIENCIES IN GSA'S ECONOMIC ANALYSIS

Because it was necessary to become familiar with some of the cost elements during our review of the economic analysis, we questioned certain elements when they appeared unreasonable in light of other available information. However, we did not fully examine all cost elements for their accuracy and were unable to independently estimate the amounts of "other costs" that should be considered (see p. 8). Therefore, the figures in the following table should not be relied on in comparing the relative present value life cycle costs of the three alternatives. They do illustrate, however, the significance of the problems we noted on certain cost elements and the need for GSA to prepare a new analysis. Explanations on those cost elements examined by us are contained on the pages following the table.

Comparison of GSA and GAO Estimated Present Value Cost

ALTERNATIVE	Estimated present value cost (note a)
Renovation:	
Total per GSA analysis	$ 16,285,100
Total after GAO adjustments	$ 39,227,300
Construction:	
Total per GSA analysis	$ 36,886,700
Total after GAO adjustments	
--assuming Customhouse can be sold	$ 42,804,500
--assuming Customhouse cannot be sold	$ 64,373,500
Leasing:	
Total per GSA analysis	$ 20,909,000
Total after GAO adjustments	
--assuming Customhouse can be sold	$ 23,307,700
--assuming Customhouse cannot be sold	$ 44,876,700

a/The details of GSA's estimates are in the enclosure, page 11.

Real estate taxes questionable

Office of Management and Budget Circular A-104 requires that the estimated local property taxes be included in the estimated life cycle costs of Federal ownership and operation of real property. The method used by GSA to estimate imputed real estate taxes is questionable. GSA's application of tax rates resulted in real estate taxes that appear unrealistic in relation to actual real estate taxes paid in New York City. Furthermore, in the case of the renovation alternative, the real estate tax rates used by GSA were applied to an amount (appraised value of the Customhouse plus capital improvements) which was significantly understated.

The real estate taxes computed by GSA were based on published tax rates. However, application of the published rates results in real estate taxes that appear excessively high. For example, the real estate taxes calculated by GSA for the new construction alternative were $3.9 million annually, or $16.60 per square foot of occupiable space. The leased space would be rented for $19 per occupiable square foot. This implies that the lessor would have only $2.40 per square foot to cover operating expenses and profit after paying real estate taxes of $16.60 per square foot.

GSA pays through a trustee much lower real estate taxes for the Federal Plaza Annex in New York City. This building was financed by the sale of purchase certificates, with title to the land held by the Government and title to the improvements held by a trustee and subject to real estate taxes. The cost of the improvements excluding land was about $59 million. In 1977 GSA paid real estate taxes of about $2 million on the improvements, and in 1978 paid about $1.9 million. Thus, the actual taxes paid in relation to the cost of the improvements were about 3.2 percent each year, or $3.70 per square foot of occupiable space.

GSA also understated the base in which the real estate tax rates should be applied for the renovation alternative. GSA included only $6.9 million of the total estimated renovation costs of $24.7 million. GSA added that amount to the appraised market value of the land and building in its present condition--about $17.1 million. Thus, GSA's estimate of its value for real estate tax purposes after renovation is about $24 million.

From our analysis of the renovation work GSA proposed to do, we believe that at least $17.6 million should be considered capital improvements. That sum would increase its potential market value to about $34.7 million, or about 45 percent higher than GSA's estimate. The work items that appear to us to be capital improvements are the following.

Install central air conditioning and replace heating system	$ 5,780,000
Replace electric service and increase capacity	3,476,000
Fire, life, and property safety	2,330,000
Upgrade and convert elevators	1,808,000
Upgrade interior space	2,552,000
Replace windows	1,684,000
Total	$17,630,000

In summary, an estimated real estate tax of about 3.2 percent of market value for New York City property is probably closer to reality than GSA's estimate (calculated by GAO to be 9 percent). Therefore, using the tax experience of the Federal Plaza Annex and adjusting the renovation project cost for applicable capital improvements, we calculated new present value estimates for the real estate taxes of $9.7 million and $12.1 million for the renovation and construction alternatives, respectively. GSA's estimates were $19.3 million and $34.9 million, respectively.

Improvements not included in residual value

GSA's estimate of $1.9 million for the market value of the land and renovated Customhouse after 30 years is based on its assumption that only $6.9 million of the renovation work would increase its market value. As described above, we believe that at least $17.6 million of the proposed work would be for capital improvements. Thus, we estimate the residual value after 30 years would be about $2.5 million, or $600,000 higher than GSA estimated.

Inappropriate reductions for lease costs

GSA inappropriately reduced the present value costs for the construction and renovation alternatives by $33.1 million, which represented GSA's estimate of the present value cost of leasing office space in New York City for 30 years. The apparent rationale for this reduction was that if either the construction or renovation alternative were adopted, GSA would not have to lease the required space. While this is obviously true, the reduction of the estimated costs of construction and renovation by the amount of the "avoided" leasing costs is analytically unsound. By the very nature of the act of comparing the cost of one method of meeting a space requirement to that of one or more alternative methods and selecting a specific alternative one is implicitly considering the avoidance of the cost of the other alternatives. Since GSA procedures provide for these adjustments, they should be revised to conform with sound economic analysis criteria.

Leasing cost understated

The total occupiable square feet in the Customhouse is 238,117. For the construction alternative, GSA estimated costs for a Federal building of the same size. However, GSA calculated the alternative leasing costs for only about 197,000 square feet. A GSA official said the primary reason for using the net figure in determining the lease cost was that some of the space in the Customhouse would be used by commercial establishments. In this regard, the prospectus states that about 23,500 square feet of the Customhouse is being considered for public use in accordance with the Public Buildings Cooperative Use Act of 1976.

In our opinion, the annual lease cost should be based on the total occupiable space of 238,117 square feet, because this was the square footage figure used to arrive at the total costs for the renovation and construction alternatives. Otherwise, a proper comparison of the relative economic cost of the three alternatives is not appropriately presented. Therefore, we estimated a present value leasing cost of $40 million based on 238,117 square feet, versus GSA's estimate of $33.1 million based on 197,000 square feet.

Factors affecting retention of building inappropriately addressed

A difference of opinion exists within GSA as to whether or not the U.S. Customhouse can in fact be sold due to its historical nature. This issue was inappropriately addressed in GSA's economic analysis.

GSA's cost estimates for both the leasing and construction alternatives include a $4.5 million present value cost for maintaining the U.S. Customhouse in a mothballed state for 30 years (the life of the altered building). However, the same analysis also shows a reduction in the costs of the leasing and construction alternatives of $17.1 million, which is an appraisal of the current market value of the U.S. Customhouse obtained by GSA from an independent real estate firm.

Obviously, both sale of the Customhouse and its retention for 30 years could not take place. If the Customhouse can be sold, a reasonable approximation of its price is an appropriate offset to the cost of the leasing and construction alternatives. On the other hand, if there is a greater possibility that it would not be sold, the $4.5 million maintenance cost should be added to the leasing and construction costs to reflect the Federal Government's continued maintenance of the U.S. Customhouse. Nevertheless, the two cost elements should not be shown in the same economic analysis. The cost of mothballing or proceeds from the sale of the building should be reflected in separate analyses if each represents a valid possibility for the building.

Other costs should be condidered

GSA did not include certain costs in its economic analysis for various items required by Office of Management and Budget Circular A-104. For example, A-104 also requires that economic analyses include the estimated cost of standard, commercial insurance coverage as an imputed cost of Government ownership and operation. While this item is probably not a relatively significant cost, it should be reasonably estimated and only excluded if it is too small to affect the comparison.

Another cost GSA did not consider in its analysis is major building repairs normally experienced over a 30-year life cycle. These would include repair and/or replacement of roofs, mechanical equipment, heating/air conditioning systems, etc. This element should be estimated and included in both the renovation and construction alternatives.

We did not independently develop estimates for the cost elements required by A-104 that GSA omitted. However, GSA should include such costs in its revised economic analysis. Furthermore, GSA's procedures for economic analyses should be revised accordingly.

Our observations on GSA's economic analysis were discussed with the Acting Executive Director of the Public Buildings Service and the official of the Repair and Alteration Division who was responsible for its preparation. These officials generally agreed with our views.

CONCLUSIONS

The prospectus submitted by GSA to the Office of Management and Budget and the Public Works Committees did not reasonably portray the present value life cycle costs of the three alternatives of renovating the Customhouse, constructing a new building, or leasing equivalent space. Because the estimates need to be recalculated for significant elements in each alternative, one cannot judge which of the alternatives is the least costly. In addition, the question of whether the U.S. Customhouse can be sold remains unanswered. It would appear that if the Customhouse could be sold at the appraised value, leasing would probably be substantially less costly. If not, renovation and use of the Customhouse might be more favorable economically, unless some excluded costs, such as major building repairs, are significant enough to affect the comparison.

While some deficiencies in GSA's analysis were due to errors or oversight, others were caused by following procedures which did not conform to Office of Management and Budget Circular A-104. The latter type, if a regular practice in GSA, could affect the reliability of such analyses for proposed major repairs and alterations projects.

RECOMMENDATIONS

We recommend that the Administrator of General Services:

--Submit a revised prospectus to the Office of Management and Budget and the Senate and House Public Works Committees, supported by an economic analysis which complies with Office of Management and Budget Circular A-104. (The base cost figures used in the economic analysis also should be reviewed for their reasonableness, and adjusted accordingly.)

--Make every effort necessary to determine whether the U.S. Customhouse can in fact be sold. This issue should be addressed in the revised prospectus.

--Direct the Public Buildings Service to (1) change the procedures for economic analyses in the GSA Handbook for the Repair and Alteration Program where necessary, to conform with the Federal policy and guidance in Circular A-104 and (2) review current prospectuses for proposed projects to determine if the economic analyses supporting them conform with Federal policy for such analyses.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen of the House and Senate Committees on Appropriations, the House Committee on Government Operations, the Senate Committee on Governmental Affairs, the House Committee on Public Works and Transportation, and the Senate Committee on Environment and Public Works; and the Director, Office of Management and Budget.

Sincerely yours,

R.W. Gutmann

R. W. Gutmann
Director

Enclosure

GSA ECONOMIC ANALYSIS SUPPORTING THE RENOVATION PROJECT FOR THE U.S. CUSTOMHOUSE, NEW YORK CITY

Renovation	Present value cost
Renovation costs	$ 20,435,000
Operation and maintenance and repairs	11,560,100
Real estate taxes	19,320,300
Residual value	(1,890,300)
Lease savings	(33,140,000)
Total	$ 16,285,100

Construction	
Construction costs	$ 39,204,500
Operation and maintenance and repairs	11,560,100
Real estate taxes	34,887,800
Residual value	(2,994,700)
Current market value of Customhouse	(17,100,000)
Mothballing Customhouse	4,469,000
Lease savings	(33,140,000)
Total	$ 36,886,700

Leasing	
Leasing costs	$ 33,140,000
Initial space alterations	400,000
Current market value of Customhouse	(17,100,000)
Mothballing Customhouse	4,469,000
Total	$ 20,909,000