OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

Contracting of Real Estate Management Services

Audit Report

June 12, 2013

Report Number SM-AR-13-001

OFFICE OF
INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

HIGHLIGHTS

June 12, 2013

Contracting of Real Estate Management Services

Report Number SM-AR-13-001

BACKGROUND:
In June 2011, the U.S. Postal Service awarded a contract to CB Richard Ellis, Inc. to be the sole provider of real estate management services to more effectively use its limited resources. Outsourcing real estate management services to one supplier is a fundamental change from how the Postal Service previously managed its real estate portfolio. Our objectives were to assess the inherent risks of the contract and determine whether the Postal Service effectively provided oversight to reduce these risks.

WHAT THE OIG FOUND:
Postal Service Facilities officials should improve oversight to mitigate inherent risks associated with the CB Richard Ellis contract. Specifically, there are conflict of interest concerns and no maximum contract value. In addition, the contracting officer did not properly approve contract payments, appoint contracting officer's representatives to monitor contract performance, or ensure services were provided. As a result, it is difficult for the Postal Service to determine whether the outsourcing effort has been or will be effective in reducing costs.

Conflict of interest concerns exist because the contractor provides a range of property values to negotiate a lease and receives a commission from the lessor based on the property value negotiated. Further, the contractor acts on behalf of the Postal Service in negotiating leases and the contractor can also represent the lessor. The Postal Service established a targeted incentive for reduced lease rates but in the first year of the contract did not meet the target. In addition, Facilities officials did not establish a maximum contract amount, which poses the risk of escalating contract costs. Officials increased contract funding from $2 million to $6 million and, as of February 2013, contract payments exceeded $3 million.

Lastly, in fiscal year 2012, employees not appointed contracting officer's representatives certified $1.7 million for invoices, including $1.1 million for services requested and certified by the same individual, which presents an increased risk of fraud. Ineffective contract oversight poses an increased risk to the Postal Service's finances, brand, and reputation.

WHAT THE OIG RECOMMENDED:
We recommended management establish a reasonable maximum contract value based on historical budgets, designate contracting officer's representatives, and specify their duties to monitor contract performance and approve payments.

Link to review the entire report

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

June 12, 2013

MEMORANDUM FOR: TOM A. SAMRA
VICE PRESIDENT, FACILITIES

E-Signed by Michael A. Magalski
VERIFY authenticity with eSign Desktop

FROM: Michael A. Magalski
Deputy Assistant Inspector General
for Support Operations

SUBJECT: Audit Report – Contracting of Real Estate Management Services
(Report Number SM-AR-13-001)

This report presents the results of our audit of Contracting of Real Estate Management Services (Project Number 12YG018DA000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Monique P. Colter, director, Supply Management and Facilities, or me at 703-248-2100.

Attachments

cc: Joseph Corbett
Susan M. Brownell
Albert J. Novack
Jane E. Bjork
Corporate Audit and Response Management

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Introduction

This report presents the results of our audit of the U.S. Postal Service's Contracting of Real Estate Management Services (Project Number 12YG018DA000). This self-initiated audit addresses financial risk. Our objectives were to assess inherent risks of the contract and determine whether the Postal Service effectively provided oversight to reduce these risks. See Appendix A for additional information about this audit.

In June 2011, the Postal Service awarded a contract to CB Richard Ellis, Inc. (CBRE) to be the sole provider of real estate management services. The Postal Service believed that leveraging the capabilities of a national real estate firm would allow for a more effective use of limited resources.

Conclusion

Postal Service Facilities officials should improve oversight to mitigate the inherent risks associated with the CBRE contract. Specifically, there are conflict of interest concerns and a maximum contract value was not established. In addition, contract payments were not properly approved. The contracting officer (CO) did not appoint contracting officer's representatives (COR) to monitor contract performance and ensure services were provided. As a result, it is difficult for the Postal Service to determine whether the outsourcing effort has been or will be effective in reducing costs.

Conflict of interest concerns exist because the contractor provides a range of property values to negotiate a lease and then receives a commission from the lessor based on the property value negotiated. Further, the Postal Service pays the contractor to act on its behalf in negotiating leases and the contractor can also represent the lessor. The Postal Service established a targeted incentive for reduced lease rates; however, in the first year of the contract, the agency did not meet this target.

In addition, Facilities officials did not establish a maximum amount for this contract, which poses the risk of escalating contract costs. For example, Facilities officials increased contract funding from $2 million to $6 million. As of February 2013, contract payments exceeded $3 million.[1]

Lastly, in fiscal year (FY) 2012, employees who were not appointed CORs certified $1.7 million for invoices, including $1.1 million for services requested and certified by the same individual, which presents an increased risk of fraud. Ineffective contract oversight poses an increased risk to the Postal Service's finances, brand, and reputation.

[1] Overall contract costs for real estate management services have declined from prior years because fewer contractors are being used for facilities management services.

Inherent Contract Risks

Postal Service officials should improve contract oversight to mitigate inherent risks associated with this contract. Specifically, there are conflict of interest concerns and a maximum contract value was not established at the time the contract was awarded. As a result, it is difficult for the Postal Service to determine whether the outsourcing effort has been or will be effective in reducing portfolio costs.

Conflict of Interest

Conflict of interest concerns exist because the contractor provides a range of property values[2] to negotiate the lease and then receives a commission from the lessor based on the property value negotiated. Further, the Postal Service pays the contractor to act on its behalf in negotiating leases, and the contractor can also represent the lessor.[3] These conflicts of interest give the appearance of impropriety because if the lessor establishes a higher rent, the contractor will receive a higher commission. The Postal Service established a targeted incentive for reduced lease rates. However, in the first year of the contract, CBRE failed to meet this operational performance target. If not adequately monitored, these risks could negatively impact the overall costs of the Postal Service's real estate portfolio.

Maximum Contract Amount

A maximum contract value was not established at the time the contract was awarded. Facilities officials believed a maximum contract amount was unnecessary because real estate expenses would have occurred anyway during normal Facilities operations. Under Postal Service policy,[4] Postal Service officials should have established the final contract price by applying a formula based on the relationship between the total final negotiated cost and total target cost. The contract was initially funded for $2 million and has since been increased to $6 million. Actual contract payments exceed $3 million. Without establishing a maximum contract value the Postal Service is at risk of escalating uncontrolled future contract costs.

Contract Payments

Facilities officials must improve internal controls over the certification of payments for services rendered by the real estate contractor. Specifically, of 239 CBRE invoices reviewed for FY 2012 (valued at $1.9 million), we identified 227 invoices totaling $1.7 million in which the Facilities employee approving the invoice was not the CO or an

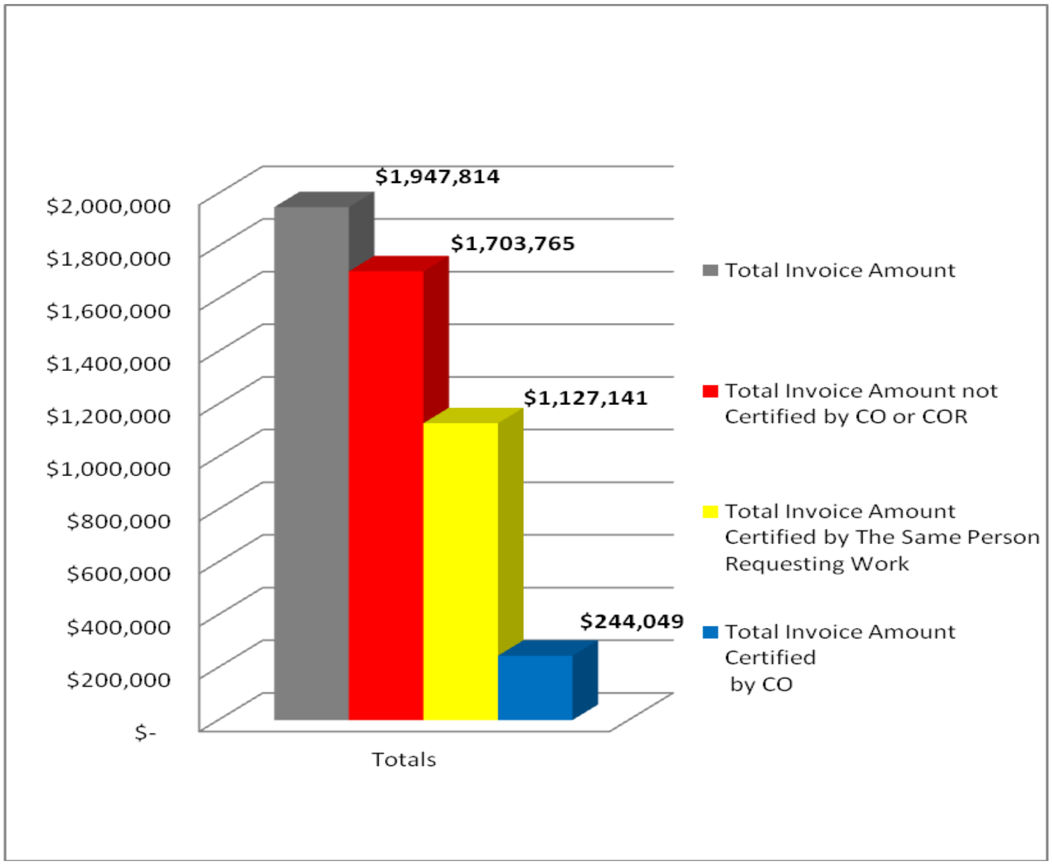
[2] According to Facilities officials, the contractor bases its property values on actual market data from a variety of commercial property resources. These values are used to estimate market value ranges in cases where a third-party appraisal is not warranted.

[3].This type of commercially acceptable real estate transaction, called dual agency, occurs when the listing broker represents both the seller and the buyer.

[4] *Supplying Principles and Practices*, Section 2-18.4.

appointed COR. Of the 227 invoices, we identified 124 totaling $1.1 million approved and certified by the same Facilities employee who requested the work order (see Figure 1).

Figure 1. Analysis of CBRE Invoice Payments



Source: Postal Service Electronic Data Warehouse (EDW) payments to suppliers.

Postal Service officials did not effectively provide oversight to mitigate inherent contract risks and ensure contract payments were properly approved because CORs were not appointed to monitor contract performance and ensure services were provided before payment. Before the CBRE contract, Postal Service employees who had contracting authority to finalize lease negotiations and property sales were responsible for soliciting contractors to perform real estate management services for leases and disposals. After the CBRE contract was awarded, the operating environment within Facilities changed and CBRE became solely responsible for coordinating and soliciting real estate management services. In the new environment, employees with contracting authority who used to perform these duties were uncertain of their new role in working with CBRE. Further, the CO did not formally designate responsibilities to employees for monitoring contract performance and approving invoices for payment.

Postal Service officials contend that CORs were not required for this contract because employees with contracting authority already served in this role and are authorized to approve CBRE contract payments. Although these employees were granted contracting authority for real estate services they did not have formal contracting authority on this specific contract. Under the CBRE contract, the CO should have appointed CORs. In the current environment, these employees can request real estate management services through CBRE and also certify CBRE invoices. In a strong internal control environment, these duties should be performed by two different individuals.

One of the roles and responsibilities of a CO is to delegate day-to-day management of contracts to other individuals, specifically a COR. [5] The COR represents the CO in dealings with the supplier. When CORs are appointed, the CO must prepare a detailed Letter of Appointment that contains, at a minimum, COR roles and responsibilities, recordkeeping duties, and delegated contract management duties. Formally appointing CORs could improve contract oversight, strengthen internal controls by separating duties, and minimize overall risk to the Postal Service.

We classified the value of the 227 invoices ($1.7 million) in which the Facilities employee approving the invoice was not the CO or an appointed COR as unsupported questioned costs. These costs are not considered unreasonable but are questionable because officials did not follow a significant internal control procedure.

Recommendations

We recommend the vice president, Facilities:

1. Establish a reasonable maximum contract value based on historical budgets.

2. Designate contracting officer's representatives and specify their duties to monitor contract performance and approve payments.

Management's Comments

Management stated in subsequent correspondence that they agreed with our recommendations but did not agree with our specific findings and monetary impact. Regarding recommendation 1, management will establish a reasonable maximum contract value by June 24, 2013. With regard to recommendation 2, management intends to designate real estate specialists as CORs and the designations will be completed on or before July 1, 2013. The CORs will be responsible for requesting services and the negotiations for services and will subsequently certify to the CO that services were received. The CO will contract for the services and approve the invoice for payment.

Management stated that outsourcing real estate management services will improve consistency and facilitate increased focus on overall real estate goals of generating revenue and reducing expense. Further, they stated that outsourcing real estate services is a prudent and commercially acceptable business decision not only

[5] *Supplying Principles and Practices,* Section 3-5, Appoint Contracting Officers Representatives.

implemented by the Postal Service but by other government agencies. Management indicated that conflict of interest concerns have been mitigated by using real estate specialists to review estimated property values used for negotiations. In cases where the estimated property value or annual rent exceeds $150,000, the Postal Service obtains third-party appraisals to establish market value. Finally, management stated that the contractor has acted on behalf of both the Postal Service and lessors in negotiating leases only 12 times since the real estate management services contract was awarded. See Appendix C for management's comments in their entirety.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the recommendations and corrective actions should resolve the issues identified in the report. The OIG supports management's efforts to maximize the value of the Postal Service's assets and reduce leased portfolio costs. However, as with any business decision, associated risks should be properly monitored to ensure efforts will be effective and result in favorable outcomes.

The OIG considers all the 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.

Appendix A: Additional Information

Background

The Postal Service's real estate objectives are to acquire, lease, build, and expand facilities to support operations. Challenges in the economy, shifts in technology, as well as other factors have led to a change in the Postal Service's real estate goals and objectives. Currently, the Facilities organization is focused on consolidating and disposing of excess space and vacant properties to optimize operations, generate revenue, and reduce real estate expenses. In June 2011, the Postal Service awarded a firm-fixed contract with an award fee to CBRE as its sole provider of real estate management services. Accordingly, CBRE assumed many of the duties formerly performed by Postal Service real estate specialists and other real estate contractors. Since the contract was awarded, the Postal Service has paid more than $3 million to CBRE for real estate support. This figure represents the initial phase of this contract and no language in the contract limits future real estate support costs.

CORs are assigned to administer contracts and ensure all contract terms are carried out. They are ultimately responsible for ensuring the Postal Service has received the requested goods and services and has been invoiced correctly before rendering payment. A CO may delegate a portion of his or her responsibility to a COR through a letter of designation. The COR may be assigned a wide range of responsibilities for administering contracts, which may include certifying invoices, performing inspections, and accepting goods and services. In carrying out COR responsibilities, the representative should be properly trained, appointed, and terminated when appropriate. It is also important that CO and COR duties be clearly defined to ensure proper separation of duties.

Objectives, Scope, and Methodology

Our objectives were to assess inherent risks of the contract and determine whether the Postal Service effectively provided oversight to reduce these risks.

To accomplish our objectives we:

- Analyzed payments made to CBRE from October 2011 through September 2012 relating to the contracting of real estate management services under Contract Number 109480-11-B-0076.

- Interviewed management and staff from Headquarters Facilities and the Great Lakes Facilities Service Office to determine the current and former processes Postal Service real estate specialists, asset managers, and CBRE staff members used when completing lease negotiations and disposal projects.

- Met with employees and representatives from the Association of U.S. Postal Lessors to discuss their concerns about the CBRE contract and their experiences when negotiating with CBRE.

We conducted this performance audit from February 2012 through June 2013 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management on May 2, 2013, and included their comments where appropriate.

We assessed the reliability of computer-generated data by comparing source documents to data in the electronic Facilities Management System and the EDW to validate monetary amounts and the certifying official. We determined that the data were sufficiently reliable for the purposes of this report.

Prior Audit Coverage

The OIG did not identify any prior audits or reviews related to the objectives of this audit.

Appendix B: Monetary and Other Impact

Monetary Impact

Recommendation	Impact Category	Amount
2	Unsupported Questioned Costs[6]	$1,703,766

Other Impact

Recommendation	Impact Category	Amount
2	Goodwill/Branding[7]	None

We calculated $1.7 million in unsupported questioned costs by identifying the total number of invoices paid from October 1, 2011 to September 30, 2012 and not certified by the CO or a COR.

[6] Claimed because of failure to follow policy or required procedures but does not necessarily connote any real damage to Postal Service.
[7] An actual or potential event or problem that could harm the reputation of the Postal Service.

Appendix C: Management's Comments

TOM A. SAMRA
VICE PRESIDENT, FACILITIES

UNITED STATES POSTAL SERVICE

May 21, 2013

JUDITH LEONHARDT, DIRECTOR, AUDIT OPERATIONS
OFFICE OF INSPECTOR GENERAL
1734 NORTH LYNN STREET
ARLINGTON, VA 22209-2020

SUBJECT: Contracting of Real Estate Management Services
Draft Audit Report (Report Number SM-AR-13-DRAFT)

Thank you for the opportunity to review and comment on the above subject draft audit report. Management appreciates the efforts the Office of Inspector General (OIG) has taken with respect to Contracting of Real Estate Management Services. The following is in response to the above subject audit and management's comments with respect to the findings of such audit.

Management offers the following comments:

The contract was designed to provide a streamlined, organized and effective process in an ongoing effort to improve consistency and facilitate increased focus on overall real estate goals of generating revenue and reducing expense. The primary objectives were targeted toward selling properties and renewing leases. Historically, the Postal Service had been using multiple real estate service contractors for dispositions. However, since the Postal Service's real estate activities not only includes disposals, but involves renewing more than 5,000 leases annually, and because staffing continues to attrite at increasing rates, capitalizing on the expertise of a nationally recognized real estate services provider was determined to be a favorable business decision. Therefore, to address the increasing volume of real estate transactions, together with increasing staff attrition, the Postal Service issued a RFP to solicit a single contractor with the organization, capability and experience to provide commercial real estate management services nationally.

Secondly, the contract was structured to allow for the Postal Service to engage C.B. Richard Ellis (CBRE) to coordinate and manage internal due diligence efforts that are required prior to marketing a property for sale and/or entering into lease negotiations. Please note, there is no base contract fee. CBRE is compensated for its services based solely on transactions and services completed as follows:

1) The Postal Service pays a commission to CBRE for a completed disposal/outlease transaction tied to a contractually agreed to fee structure
2) The Postal Service does not compensate CBRE for a completed lease transaction. In accordance with generally accepted commercial real estate practices, the Lessor is responsible for paying a commission for completed lease transactions.
3) The Postal Service pays an [redacted] percent due diligence management fee for coordination/tracking of 3rd party vendor reports, when needed.

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The OIG report indicates officials did not effectively provide contract oversight to mitigate inherent risks. Further, it states the lack of adequate oversight posed financial risks and potential damage to the Postal Service's finances, brand and reputation. The Postal Service communicated to Lessors, the Association of United States Postal Lessors and other Postal Service employees the decision to outsource some of its real estate activities. We do not believe such outsourcing has tarnished the Postal Service's reputation. It has only reinforced that the Postal Service continues to seek opportunities and strategies that ultimately result in favorable outcomes that are determined to be in the best interest of the Postal Service, economically and operationally. Outsourcing real estate services is a prudent and commercially acceptable business decision not only implemented by the Postal Service, but other government agencies, including General Services Administration. Capitalizing on the expertise of a nationally recognized leader in its industry is viewed as a strategic strength. It indicates to the world that the Postal Service has a solid understanding of real estate markets and what it needs to do to maximize the value of its owned assets and reduce the expense associated with its leased portfolio.

Additionally, the report states that a maximum contract amount was not established which poses a risk of escalating contract costs. Management agrees that determining a maximum contract value will provide a check point to ensure the services provided are satisfactory and; therefore, continuation of the contract is in the best interest of the Postal Service. Please note, the maximum may need to be adjusted based on actual flow of transaction volume.

The report indicates a conflict of interest concern because the contractor provides a range of property values to negotiate a lease, then receives a commission from the lessor based on the property value negotiated. Management does not believe there is reason for concern. The contractor provides actual market data from a variety of commercial property resources, including Costar and LoopNet that subsequently is used to estimate market value in cases where a 3rd party appraisal is not warranted. The Postal Service's real estate specialists review the comparisons used to calculate the estimates and determine whether or not such estimates are acceptable to be used as a benchmark for negotiations. In cases where the estimated property value or annual rent exceeds $150,000, the Postal Service obtains 3rd party appraisals to establish market values.

The report further states that CBRE can represent both the Postal Service and the Lessors in transactions. This is referred to as dual agency. The Postal Service has established a procedure where by Dual Agency must be approved in writing by both the Postal Service and Lessor or Purchaser. The Postal Service's law deparment assisted in drafting and approved the dual agency document that currently is being used. Dual agency is a commercially acceptable practice and is approved at the sole discretion of the Postal Service. Since the contract award in June 2011 through December 2012, there have been only 12 cases of dual agency. Additionally, dual agency was experienced under the previous structure whereby the Postal Service used multiple real estate services firms as well. Finally, dual agency does not limit the services the real estate agent provides regarding offering advice and negotiations. Though the firm is the same, it typically involves completely different broker/agents.

Lastly, the report references $1.7M for fiscal year 2012 invoices that were not certified by contracting officer representatives (CORs). Please note CORs are not necessarily required under a real estate services contract. Every real estate specialist has been delegated authority as a contracting officer based on their respective levels of responsibility that affords them the ability to certify invoices under any and all real estate services contracts. This delegation of authority is done in the same spirit as the concept of a COR. Also, the report notes that of the invoices totaling $1.7 million, $1.1 million of which was requested and certified by the same real estate specialist, which presents an increased risk for fraud. Although on average the individual invoices are considered low risk, management agrees that since there may be an appearance of risk, we will immediately address the situation by ensuring separation of duties between the real estate specialist and the contracting officer by designating the real estate specialists as CORs. The real estate specialists/CORs will be responsible for requesting the services and any negotiations for the services, then subsequently will certify to the contracting officer that the services were received as requested. In turn, the contracting officer will contract for the services and approve the invoices for payment.

Audit Recommendations. Management's comments with respect to the recommendations outlined in the audit report are noted below:

Recommendation 1: Establish a reasonable maximum contract value based on historical budgets.

Management Response: As previously discussed and stated above, management will use best efforts to establish a reasonable maximum contract value by June 24, 2013, to align with the beginning of the third year of the base contract term.

Recommendation 2: Appoint contracting officer's representative to monitor contract performance and certify payments.

Management Response: As previously discussed and stated above, management intends to designate real estate specialists as CORs who will be responsible for requesting the services and negotiations for services, then subsequently will certify to the contracting officer that the service was received as requested. In turn, the contracting officer will contract for the services and approve the invoice for payment. Such designations will be completed on or before July 1, 2013.

Further, management recommends an annual audit of work orders and related payments to validate that such policy has been implemented and adhered to accordingly.

Please note, management does not believe that this report contains any proprietary or business information and may be disclosed pursuant to the Freedom of Information Act.

Tom A. Samra

cc: Megan Brennan
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Jane E. Bjork
Corporate Audit and Response Management