

# Understanding Federal Asset Management: An Agenda for Reform

Financial Management Series



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IBM Center for  
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FINANCIAL MANAGEMENT SERIES

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## F O R E W O R D

July 2003

On behalf of the IBM Center for The Business of Government, we are pleased to present this report, “Understanding Federal Asset Management: An Agenda for Reform,” by Thomas H. Stanton.

This report is an introduction to the how the federal government manages its many assets, including billions of dollars’ worth of real and personal property, inventories, and loans. Over time, the IBM Center plans to build upon this report by Mr. Stanton with case studies of different types of assets at various stages of the asset management life cycle: acquisition, operations and maintenance, remediation, and disposition.

In this report, Mr. Stanton describes different types of federal assets and the state of asset management today. He presents case studies of agencies that have engaged in promising practices. The best practices identified by Mr. Stanton can serve as examples for others in the federal government. The report also examines the statutory and other constraints that impede management of federal assets—constraints not faced by the private sector in the management of their properties. The report concludes with recommendations for reform.

The time is now ripe to begin using both the lessons learned and the leading best practices of organizations in the public and private sectors that have attempted to reform their asset management practices. Solutions should not only correct long-standing problems, but also should be responsive to agencies’ changing missions and security concerns, as well as the technological needs of the 21st century.

We trust this report will be informative and useful to federal policy officials and public managers who seek to strengthen federal asset management and to increase the capacity of the federal government to carry out their missions.

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## EXECUTIVE SUMMARY

Asset management is becoming a priority for the federal government. By improving asset management, agencies can present a better face to the American public, enhance their work environments, and increase capacity to carry out their missions.

The federal government holds or manages a huge volume of assets, including buildings and real property, financial assets, personal property, and fleet assets. Within the United States, the government owns over 30,000 different installations including over 440,000 buildings with a floor area of almost 3 billion square feet. In addition, the government leases 46,000 buildings within the United States with a building floor area of almost 340 million square feet. Financial assets of the federal government include accounts receivable, such as tax debts or defaulted federal loans, and direct loans outstanding. At the end of FY 2002, the federal government held \$248 billion in outstanding direct loans.

This report seeks to provide a framework for assessing the dimensions of federal asset management. It begins by surveying different types of federal assets and the state of asset management today. It then presents case studies of agencies that have engaged in promising practices that might serve as examples for others in the federal government. These promising practices include examples at different stages of the asset management cycle: acquisition, operations and maintenance, remediation, and disposition.

The report then examines some of the statutory and other constraints that impede management of federal assets in contrast to the private sector. There

are important limitations, especially in budget scoring, that need to be addressed so that federal asset management can live up to its potential and realize the many benefits—in terms of enhanced agency capacity, taxpayer savings, and preservation of scarce resources—that good asset management can provide. For example, the federal government increasingly leases buildings when it would be much cheaper to build and own them. Under the budget scoring rules applicable to many agencies, shorter-term leasing is favored over long-term leasing or government ownership. Thus, the General Services Administration (GSA) leases almost half of the space that it manages for federal agencies (149 million square feet out of a total 345 million square feet). The percentage of leased space has grown significantly in recent years, and budget disincentives appear to drive this uneconomical result.

Even within today's constraints, agencies can make important progress in asset management. Most important, many agencies treat their assets on an individual basis rather than addressing the whole portfolio of assets and managing them through a comprehensive strategy. This report presents a number of examples and case studies of agencies that substantially improved the relationship of their assets to their agency mission by adopting a portfolio approach. The United States Coast Guard, for example, has taken an integrated approach to acquisition of deepwater assets, such as ships, boats, planes, helicopters, and systems, to ensure that it acquires the most appropriate mission-related assets within its budget. The GSA's Public Buildings Service is implementing a portfolio strategy for the real prop-

erty assets that it manages. In addressing the end of the asset cycle, the Small Business Administration (SBA) took a comprehensive look at its business loan guarantee program and determined that sales of nonperforming loan assets could save considerable resources that the agency then could use more productively to further its mission of supporting small businesses. In contrast to these examples, the lack of a comprehensive portfolio strategy at many agencies can exacerbate the problem of disinvestment that affects many federal agencies.

Another theme is the need to structure the relationship with third parties such as contractors so that the incentives of the government and the private party are aligned. The Resolution Trust Corporation (RTC) provides a remarkable example of an agency that evolved its relationships into increasingly efficient forms. The Department of Energy's experience with performance-based contracting for environmental remediation at Rocky Flats reflects the same lesson.

These examples lead to another lesson: Leadership from the top is essential to help an agency make difficult strategic decisions, especially if they involve new ways of doing business. Virtually all of the case studies presented here—the SBA, the Coast Guard, the Public Buildings Service, Rocky Flats, the RTC, and the Defense Reutilization and Marketing Service—reflect the involvement of top agency leaders in managing for success. Mid-level officials simply lack the position in the organization to bring all of the players together and move them in a common direction.

Agencies and policy makers also need to become more cognizant of the life cycles of the assets the government holds. It is more cost-effective to make needed investments earlier than to try to deal later with assets that have become degraded. Thus, the costs of deferred maintenance can become prohibitive for federal buildings and real property. Similarly for financial assets, it is much less expensive to take early measures to forestall loan delinquencies or defaults than it is to try to restructure or foreclose upon poorly originated or serviced loans when borrowers fail to make the payments.

The report concludes with recommendations for change. The management of federal assets is in

need of improvement, and a few basic reforms could be of great help. Five reforms stand out: (1) improvements to applicable budget rules, (2) adoption of a portfolio strategy by major federal asset holders, (3) adoption of a life-cycle approach to managing federal assets, (4) sponsorship of interagency working groups by the OMB deputy director for management, and (5) experimentation with new lease arrangements. Any changes to budget and federal property rules would need to be done carefully, with attention to avoiding creation of yet new difficulties. Proposed solutions need to be evaluated on the basis of a frank recognition of the government's capabilities to implement those solutions, rather than on the basis of what the private sector might do under similar circumstances. Given the complexity of the issues, it would be beneficial, as the General Accounting Office has suggested with respect to real property, to convene an independent commission or a government-wide task force to develop a comprehensive and integrated asset management strategy for the federal government.

# Introduction to Federal Asset Management

## Asset Management as a Federal Priority

The Bush administration has put executive branch agencies on notice that asset management is becoming a high priority. In 2001 the administration submitted a legislative proposal, the Managerial Flexibility Act, that contains a title dedicated to reform of federal property management. This has been followed by a section of the fiscal year 2004 federal budget calling for strengthening of federal asset management. The budget states that “the Administration will monitor agency asset management practices as a part of the Improved Financial Performance initiative [of the President’s Management Agenda].”<sup>1</sup>

There is good reason to focus on federal asset management. It involves huge amounts of real property, federally owned and leased facilities, fleets, financial assets, personal property, and other kinds of assets, and represents, as the FY 2004 budget states, an area where federal practices have been shown to be particularly weak. By improving asset management, agencies can present a better face to the American public, enhance their work environments, and increase their capacity to carry out their missions.

As often is the case in calls for improved management, the problem of federal asset management involves complex issues and constraints that often prevent even well motivated federal agencies from making the needed improvements by themselves. That the administration introduced reform legislation provides a clue that legal barriers exist to many forms of improved asset management. There also

has been interest on Capitol Hill. On June 19, 2003, Rep. Pete Sessions (R-TX) introduced the Federal Property Asset Management Reform Act of 2003 (H.R. 2548), which would significantly alter the legal framework applicable to federal asset management practices. There are, however, many examples of agencies that have greatly enhanced the quality of their asset management, even within current constraints.

This report seeks to provide a framework for assessing the dimensions of federal asset management. It begins by surveying different types of federal assets and the state of asset management today. It then presents case studies of agencies that have worked within the constraints to engage in promising practices that might serve as examples for others in the federal government. As shown in Table 1, these promising practices include examples at different stages of the asset management cycle: acquisition, operations and maintenance, remediation, and disposition. Several of the case studies relate to the largest asset categories—buildings and real property, and financial assets—and other case studies relate to personal property and fleet assets.

The report then examines some of the statutory and other constraints that impede management of federal assets in ways familiar from the private sector. Indeed, because of the many constituencies concerned with the acquisition, use, and disposition of federal assets, it is unreasonable to believe that federal agencies can completely emulate the bottom-line financial focus of private companies. Moreover, there are important limitations, especially in budget scoring, that need to be addressed so that federal



**Table 1: Case Studies, Asset Types, and the Asset Management Life Cycle**

	Acquisition	Operations and Maintenance	Remediation	Disposition
<b>Real Property</b>		General Services Administration, Public Buildings Service	Department of Energy, Office of Environmental Management	Resolution Trust Corporation
<b>Financial Assets</b>			Resolution Trust Corporation	Resolution Trust Corporation
<b>Personal Property<sup>2</sup></b>				Defense Reutilization and Management Service
<b>Fleet Assets</b>	United States Coast Guard			

asset management can live up to its potential and realize the many benefits—in terms of enhanced agency capacity, taxpayer savings, and preservation of scarce resources—that good asset management can provide. The report concludes with recommendations for reform. The appendices present a research agenda of important asset management issues and recommendations for further reading.

**Management of Federal Assets Today**

Management of many federal assets today is characterized by (1) disinvestment of government, (2) a growing discrepancy between the nature of assets in an agency’s portfolio and the needs of that agency’s mission, (3) acquisition of federal assets without consideration of the costs and effort to maintain and eventually dispose of the assets, and (4) statutory requirements that impede effective asset management.

Disinvestment results when the government fails to invest adequate amounts of money in the staff, systems, and facilities that agencies require to manage their programs well.<sup>3</sup> Budget and staff cuts have reduced the management capabilities of many agencies. One agency after another faces an increasing disconnect between growing duties and mostly static resources.<sup>4</sup>

For asset management, this means that many federal agencies may lack the capacity that is needed to manage assets in the most cost-effective manner. For buildings and real property, this means that federal agencies often lack the kinds of information needed to make sound decisions about their asset portfolios. For financial assets, the government may lack the capacity to originate, service, and collect on loans, especially where improvements might require the installation of the types of systems that support comparable private sector activities. Another consequence of disinvestment is the cost of neglected maintenance and modernization, especially of real and personal property and fleets. When an agency faces budget constraints, property maintenance too often seems easy to defer, compared to the pressures of supporting current operations.<sup>5</sup> Assets such as information systems may become obsolete if they are not regularly modernized, and this too has its costs.

The second issue facing government assets is an increasing divergence between the needs of an agency’s mission and the nature of the assets it holds. Again, buildings and real property provide the most striking examples. When an agency’s mission changes, it may require quite different assets than it needed before. The case study of Rocky Flats illustrates the asset management problems that con-

front the Department of Energy (DOE) now that nuclear weapons production has gone from being a national priority to becoming the focus of mutual reductions with the former Soviet Union. Other agencies find that downsizing or the consolidation of offices can leave them with unused or underutilized assets. Especially after September 11, with increasingly costly security requirements for federal facilities, excess or partially used buildings can be expensive for an agency to maintain.

The third issue relates to statutory and other constraints that impede effective asset management. Federal budget scoring rules are a particular problem. Past reforms, such as the institution of credit budgeting in the 1990s and the creation of the Federal Buildings Fund in the 1970s, brought progress to federal asset management. Now, however, the world has changed. To keep up, the budget scoring rules need to be reviewed once again to address critical deficiencies such as their impact on acquisition of buildings and real estate assets and on asset sales. The section entitled “Findings and Issues” addresses this matter in further detail, along with other statutory issues such as the need to modernize the Federal Property and Administrative Services Act of 1949.

## The Difficulty of Implementing Private Sector Approaches

Unfortunately, problems of disinvestment can affect the chances for success of many proposals to alleviate the problems of deteriorating and unsuitable federal assets. Any changes to budget and federal property rules would need to be done carefully. Some have proposed, for example, that agencies be allowed to retain the budget proceeds from asset sales so that they have an incentive to dispose of unneeded assets. The National Research Council points to pressures that agencies then would face to sell their assets to fund current priorities:

Given the pressures on agency senior managers and executives to focus on short-term operations instead of long-term issues of stewardship, however ... [a]gencies trying to raise funds for operating programs could be tempted to hold “fire” sales of properties that may be needed to meet future mission requirements.<sup>6</sup>

Disparities of knowledge between the public and private sectors also can be significant for a government agency that seeks to enter into transactions with its assets. Even modest proposals, such as to allow agencies to exchange properties for more suitable private real estate, can founder if the government lacks the capacity to assess the value of the properties being sold and acquired, both in monetary terms and in terms of the future value of the properties to the agency and its mission. A government agency that is not in the business may have difficulty acquiring the needed real estate expertise to engage in a single sales or exchange transaction that could have profound effects for the agency in the future.<sup>7</sup>

There may be ways to overcome some of these concerns. The point here is that, while the federal government today does face major issues of asset management, any proposed solutions need to be evaluated on the basis of a frank recognition of the government’s capabilities to implement those solutions, rather than on the basis of what the private sector might do in similar circumstances.

That said, important progress in federal asset management can be made. Most important, many agencies treat their federal assets on an individual basis rather than addressing the whole portfolio of assets and managing them through a comprehensive strategy. This report presents a number of examples and case studies of agencies that substantially improved the relationship of their assets to their agency missions by adopting a portfolio approach. The United States Coast Guard (USCG), for example, has taken an integrated approach to acquisition of deepwater assets, such as ships, boats, planes, helicopters, and systems, to ensure that it acquires the most appropriate mission-related assets within its budget. At the other end of the asset cycle, the Small Business Administration (SBA) took a comprehensive look at its business loan guarantee program and determined that sales of nonperforming loan assets could save considerable resources that the agency then could use more productively to further its mission of supporting small businesses. By contrast, the lack of a comprehensive portfolio strategy can exacerbate the problem of disinvestment that affects many federal agencies.

Finally, agencies need to become more cognizant of the life cycles of the assets they hold. It is more cost effective to make needed investments earlier than to try to deal later with assets that have become degraded. Thus, the costs of deferred maintenance can become prohibitive for federal buildings and real property. Similarly for financial assets, it is much less expensive to take early measures to forestall loan delinquencies or defaults than it is to try to restructure or foreclose on poorly originated or serviced loans when borrowers fail to make the payments.

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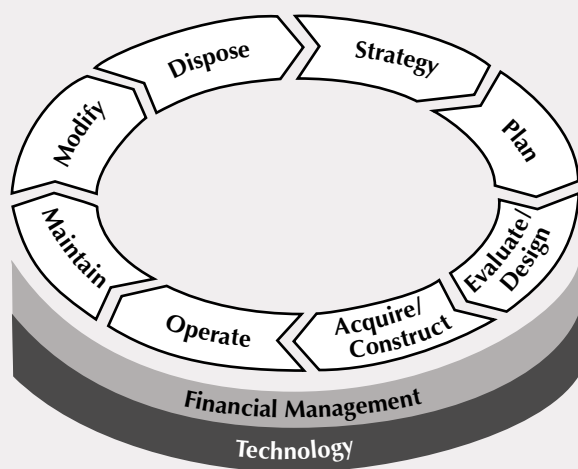
Special thanks to Bernard Ungar and Paul Posner of the General Accounting Office, who were responsible for many of the GAO reports on asset management and budget issues, respectively, that are referenced here. Experts in the private sector also contributed their knowledge, including Kim Burke and Alan Gittelsohn, contractors to GSA's Public Buildings Service; Thomas P. Horton, adviser to the Department of Housing and Urban Development; and Roger Kormendi and Cyrus Gardner, financial advisers to the Defense Reutilization and Management Service.

# Total Life Cycle Asset Management

by Joel P. McGlynn

Today's government asset management environment is characterized by a growing gap between an organization's asset portfolio and its current organizational mission and strategy. Couple that with inadequate investment in staff, and systems required to manage assets in the most cost-effective manner for many government enterprises, and there exists a significant misalignment of an organization's asset base and the productive use of those assets. At the same time, there exists considerable pressure based on the President's Management Agenda focus on improved asset management, regulatory requirements (GASB34), and security concerns post 9/11, to better account for and manage assets.

**Figure 1: Total Life Cycle Asset Management**



*Adapted from Uptime: Strategies for Excellence in Maintenance Management by John Dixon Campbell.*

Total Life Cycle Asset Management (TLAM) is a holistic portfolio-based approach to managing assets. It provides a framework that can assist an organization to better optimize and align its asset investment to support the organization's mission and strategy. TLAM focuses on managing assets using a portfolio view across the asset's total life cycle including strategy and planning, evaluation and design, acquisition and/or build, operate, maintain, modification, and disposal. TLAM also

seeks to categorize asset classes based on similar management attributes such as financial, real property, personal property, fleet, and government infrastructure (which can include plants and equipment, and continuous assets such as transit systems, road, electrical grids, etc).

TLAM can be used to evaluate the asset management strategies and best practices at each life cycle stage with a focus on the total life cycle cost. In a real property example, you might conclude that constructing a new facility rather than leasing an existing facility may be more attractive using a total life cycle analysis. In a personal property example, you might conclude based on maintenance cost projections that procuring a new compressor may be preferable to continuing to repair and maintain the existing compressor. Finally, in a fleet example, you may conclude based on a Reliability Based Maintenance assessment for a particular component, that running to failure is preferable to potentially "error inducing" preventative maintenance.

## Asset Life Cycles

Breaking Total Life Cycle Asset Management into its constituent asset life cycle stages can provide a valuable framework to aid in better managing assets. The first phase in the life cycle of an asset is the Asset Strategy. It is developed working from the enterprise or agency strategy. It can include the overall direction of the asset base—whether to out-source, or to dispose of assets or to increase the asset base, or to improve reliability. The Asset Plan is developed to execute the strategy and requires a good accounting and status of the existing asset base. The Evaluation phase of the life cycle answers the question of how the current asset base supports the asset strategy and plan. The Design phase focuses on capital projects definition and planning, configuration management, project planning and collaboration, specifications management, design for maintainability, security, and land and space usage analysis. Acquisition and constructing assets is an important phase of the asset life cycle for it

**Figure 2: A Construct That Represents TLAM**

Asset Classes	Asset Strategy	Plan	Evaluate/Design	Acquire/Construct	Operate	Maintain	Modify	Dispose
Financial								
Real Property								
Personal Property								
Fleets								
Infrastructure								

- Asset Characteristics
- Tools
- Processes

Each intersection in the above chart may possess different asset characteristics, tools, and processes.

is in this stage the information records of an asset begin and ideally are maintained through the life cycle of the assets.

Operation and Maintenance of an asset are where the bulk of the life cycle costs are incurred. There are many technologies and best practices applicable to a government enterprise to assist in maximizing the productive use of assets during these phases. For personal property, they include Predictive and Preventative Maintenance and even Autonomous Maintenance (Self-diagnostic and Repair). Best practices include Total Productive Maintenance, Total Asset Visibility, and the implementation of Enterprise Asset Management solutions. Finally, Asset Modification and Disposal represent the later stages of the life cycle of an asset. Often these stages are most neglected and represent a large potential for asset management improvement. It is also in these later stages that current government and statutory requirements can impede effective asset management.

Each asset class has different asset characteristics that necessitate different asset management strategies, processes, and technology solutions at each stage of the asset life cycle. Taking a total life cycle portfolio view in managing assets can yield dramatic benefits to all asset stakeholders. These benefits include improved asset alignment with mission through asset strategy formulation, lower capital investment through improved asset performance and better project management, lower maintenance and operations cost through more proactive and timely maintenance, improved mission accomplishment through higher asset availability and reliability, and better accountability through total asset visibility.

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# Buildings and Real Property

The federal government holds or manages a huge volume of buildings and real property. Within the United States, the government owns over 30,000 different installations including over 440,000 buildings with a floor area of almost 3 billion square feet. In addition, the government leases 46,000 buildings within the United States with a building floor area of almost 340 million square feet.

Table 2 lists the amount of building area owned and leased within the United States for federal agencies. The statistics show that a handful of departments and agencies—the Department of Defense (DoD), the General Services Administration (GSA), and the United States Postal Service (USPS)—manage about 80 percent of the total area of federal buildings that agencies own or lease. The next three organizations—the Department of Veterans Affairs (VA), DOE, and Department of the Interior—own or lease a total of another 10 percent. Different federal agencies thus have quite different needs and interests concerning federal buildings. One common issue concerns the quality of buildings in which federal officials must work: An attractive work environment is important to help attract and retain high-quality people.<sup>8</sup>

The government owns approximately 90 percent of the area occupied by federal agencies and leases the remaining 10 percent. Departments such as DoD and VA tend to own their buildings, while other departments and agencies increasingly rely on leasing. Of the buildings managed by GSA for federal agencies, about 55 percent of the area is government owned and the remainder is leased.

In addition, setting aside public lands and other “stewardship assets” (perhaps 90 percent of the total land owned by the U.S. government), the government owns literally millions of additional acres of land, including 178 million acres owned by the Department of Agriculture, 24 million acres by DoD, 2 million by DOE, and nearly 1 million by the Tennessee Valley Authority.

Personal property owned by the federal government includes supply and material inventories, agency furniture, fixtures and equipment, and stockpile inventories. Fleet assets include aircraft, ships, and motor vehicles.

In 2003 the General Accounting Office (GAO) designated federal real property as a new high-risk area. As Comptroller General David Walker writes:

Long-standing problems in the federal real property area include excess and underutilized property, deteriorating facilities, unreliable real property data, and costly space. These factors have multi-billion-dollar cost implications and can seriously jeopardize the ability of federal agencies to accomplish their missions.<sup>9</sup>

Consider several of the more important stages of the asset management cycle: acquisition, maintenance and operation, and disposition of buildings and real property.

**Table 2: Federally Owned and Leased Buildings within the United States**

Agency	Owned Building Area (Sq. Ft.)	Leased Building Area (Sq. Ft.)	Total Building Area (Sq. Ft.)	% Total Building Area
Army	743,674,487	8,771,834	752,446,321	22.7%
Navy	606,539,228	9,880,588	616,419,816	18.6%
Air Force	585,469,658	3,279,314	588,748,972	17.8%
General Services Administration	195,742,524	149,111,689	344,854,213	10.4%
United States Postal Service	220,816,091	107,452,808	328,268,899	9.9%
Veterans Affairs	136,755,332	4,712,120	141,467,452	4.3%
Energy	125,875,279	697,305	126,572,584	3.8%
Interior	78,898,916	2,668,992	81,567,908	2.5%
Agriculture	46,320,208	15,207,911	61,528,119	1.9%
Justice	51,383,089	8,216,136	59,599,225	1.8%
Transportation	46,780,232	12,180,043	58,960,275	1.8%
National Aeronautics and Space Administration	44,073,865	26,212	44,100,077	1.3%
Health and Human Services	24,527,890	2,869,199	27,397,089	0.8%
Labor	15,240,903	7,514,828	22,755,731	0.7%
Corps of Engineers	13,855,958	1,190,410	15,046,368	0.5%
Treasury	9,376,012	1,994,368	11,370,380	0.3%
Defense/WHS	7,656,390	0	7,656,390	0.2%
Commerce	5,657,150	346,456	6,003,606	0.2%
Tennessee Valley Authority	4,470,727	1,337,947	5,808,674	0.2%
Environmental Protection Agency	3,338,205	384,965	3,723,170	0.1%
National Archives and Records Administration	3,462,329	193,049	3,655,378	0.1%
Government Printing Office	1,418,900	489,946	1,908,846	0.1%
Education	1,391,832	0	1,391,832	0.0%
National Science Foundation	920,510	3,320	923,830	0.0%
Federal Emergency Management Agency	763,259	0	763,259	0.0%
Smithsonian	0	703,245	703,245	0.0%
Independent Government Offices	137,449	234,075	371,524	0.0%
State	235,403	0	235,403	0.0%
Federal Communications Commission	103,219	39,897	143,116	0.0%
American Battle Monuments Commission	0	14,000	14,000	0.0%
Total	2,974,885,045	339,520,657	3,314,405,702	100.0%
Percent of Total Building Area	89.8%	10.2%	100.0%	100.0%

Source: General Services Administration, Federal Real Property Profile as of September 30, 2002, Table 7, p. 8.

## Acquisition

With respect to acquisition of federal buildings, the situation is superior to what it was several decades ago. Until 1974, the expense of purchasing or leasing buildings for federal domestic agencies came out of a central appropriated fund for GSA. This meant that agencies served by GSA had little if any incentive to try to save money on the costs of their buildings and facilities. In 1974, Congress changed the structure of appropriations for public buildings. It created a new Federal Buildings Fund, essentially a revolving fund, administered by GSA. Agencies now receive appropriations to cover their operating rents for buildings and other facilities as a part of their annual appropriations. For newly constructed space, they pay rent to the Federal Buildings Fund in an amount that is set by independent appraisal. For a leased property, they pay the underlying contract rent, which is negotiated by GSA and the building owner, plus a fee. The result is that federal agencies today are sensitive to the costs of the space that they own or lease and are free to shop around for the most suitable arrangements.

However, that said, it is also true that the federal government frequently finds itself paying too much for space. The federal government increasingly leases buildings when it would be much cheaper to build and own them. Under the budget scoring rules applicable to many agencies, shorter-term leasing is favored over long-term leasing or government ownership. Currently GSA leases almost half of the space that it manages for federal agencies (149 million square feet out of a total 345 million square feet). The percentage of leased space has grown significantly in recent years.

GAO has issued numerous reports documenting that building and owning buildings is much less expensive, as a general rule, than leasing buildings or acquiring them through lease-purchase arrangements. Thus, GAO reported that the Patent and Trademark Office met long-term requirements by leasing space in Northern Virginia even though this was \$48 million more expensive than construction. The Department of Transportation proposed entering into an operating lease for a new headquarters building even though construction of a new building would have cost an estimated \$190 million less. In 1999 GAO reviewed nine proposed major operating

lease acquisitions and found that construction would have been the least-cost option in eight of them, with a total savings of an estimated \$126 million. As will be discussed in “Findings and Issues,” budget disincentives appear to drive this uneconomical result.

## Property Maintenance and Operation

With respect to property maintenance and operation, two problems exist: excess and underutilized property and property with such a backlog of deferred maintenance and needed alterations that conditions deteriorate. The problem of excess and underutilized federal property is especially important for those federal agencies with large holdings. Of these, DoD faces the most serious challenges. DoD is responsible for managing more than 46,425 square miles in the United States and overseas. It has a physical plant of 621,850 buildings and other structures with a replacement value estimated at about \$600 billion.

With the end of the Cold War, the department underwent substantial force reductions. Even with an anticipated build-up following September 11 and the Iraq conflict, the nature of war fighting has changed so that the department’s property needs have changed as well. DoD estimates that it spends between \$3 and \$4 billion annually to maintain facilities that it does not need.

The department has undertaken four rounds of base closures that reduced its holdings by 21 percent and has obtained authorization for a fifth round scheduled for FY 2005. In addition, the department has implemented a centrally funded demolition program that removed 62 million square feet of facilities during FY 1998 through 2001, and that total is anticipated to reach 80 million feet by the end of FY 2003.

The Department of Veterans Affairs has found itself with unused and underutilized health-care facilities that often are outdated and functionally obsolete. GAO reported that, as a result of changes in service delivery including a shift to outpatient and community-based services, VA had 5 million square feet of vacant space and that the department’s utilization of space will continue to decline. VA is



now undertaking a new initiative—known as the Capital Asset Realignment for Enhanced Services (CARES)—that has identified 31 buildings no longer needed to meet veterans’ health-care needs, including 30 that are vacant. GAO has estimated that VA is spending about \$35 million annually to maintain vacant space.

DOE is another organization that has found itself with substantial amounts of excess property because of a changed mission. The government shifted from production of nuclear weapons, and DOE found itself with 1,200 excess facilities amounting to 16 million square feet. Many of these facilities require environmental remediation before they can be disposed of.

Another major asset management problem concerns deterioration of federal assets. Federal facilities face backlogs in restoration, repair, maintenance, and modernization. Again, DoD heads the list. The department estimated in 2001 that it would cost \$62 billion to bring its facilities into minimally acceptable condition. The Department of the Interior, another department with large holdings, also has a significant deferred maintenance backlog, which the department’s inspector general estimated to be between \$8 and \$11 billion. The backlog includes an inability of the National Park Service to maintain physical assets such as Ellis Island, Independence Hall, Yellowstone National Park, and Mount Rushmore, to name some of the national treasures that figure in GAO reports. The department’s Bureau of Indian Affairs also reports a substantial backlog, including deferred maintenance of educational facilities that affects the ability of children to learn.

GSA’s Public Buildings Service (PBS) manages 40 percent of all federal workspace. GAO estimates that federal buildings managed or owned by GSA have a backlog of \$5.7 billion in identified needed repairs and alteration. Sometimes this backlog causes significant problems. As GAO reports:

The adverse consequences at several deteriorating buildings we visited included poor health and safety conditions due to dysfunctional air ventilation systems, inadequate fire safety systems, and unsafe water supply systems; higher operating

costs associated with inefficient building heating and cooling systems; restricted capability to add new information technology because of obsolete electrical systems; and continued structural deterioration resulting from water leaks.<sup>10</sup>

The affected buildings include federal buildings around the country as well as prominent landmarks such as the Eisenhower Executive Office Building in Washington, D.C.<sup>11</sup> GSA’s Public Buildings Service echoes the GAO findings. It reports that funding for reinvestment in federal buildings, including repair and modernization, has averaged approximately 25 percent below requested levels:

Because of this backlog, historic cultural and architectural components of [the affected] buildings are threatened. Many of these ... are inefficient, have ineffective or inadequate mechanical systems, and are outdated to the point of being functionally obsolete.<sup>12</sup>

## Property Disposition

Finally, federal laws, and especially the Federal Property and Administrative Services Act of 1949, constrain the ability of agencies to dispose of property that they may consider excess. Many of the applicable laws reflect constituency interests that may oppose disposition of federal property because of interests other than the pure financial value to taxpayers in the country at large. Especially in parts of the country that are losing employment and population, the closing or consolidating of uneconomic federal offices raises grave concerns. DoD has found it difficult to close unneeded military bases because of concerns about the loss of military and civilian jobs in the affected communities. This opposition exists despite evidence that base closures often result in considerable economic benefit to communities once the transition is over and the private sector can utilize the available space and facilities for more productive purposes.

The United States Postal Service (USPS) has experienced similar opposition to efforts to close or consolidate post offices and other facilities. The law prescribes a cumbersome process, including extensive consultation and analysis, before a post office

can be closed. The law expressly prohibits the USPS from closing small post offices solely for economic reasons, and the USPS has not tried to close a small post office since 1998, despite the need to replace many money-losing facilities with more efficient means of providing customer service. Congress also takes an active interest in proposed closings of larger post offices and other facilities, and it is especially concerned about the impact on employees when a facility might be closed or consolidated. The result is a significant impediment to the USPS's efforts to adapt to a changing competitive and technological environment and lower the costs of postal service.<sup>13</sup>

The Federal Property and Administrative Services Act of 1949 affects many federal agencies. The Property Act requires that agencies with excess property offer that property first to other federal agencies, then to state and local governments, and then to nonprofit organizations. The Stewart B. McKinney Homeless Assistance Act requires that agencies give extended consideration to making unneeded property available to house the homeless. If property remains in an agency's hands after this, then the agency may sell it. However, the Property Act requires that the disposing federal agency pay the costs of preparing a property for disposition. Yet, the sales proceeds, net of costs, must be deposited into either the general treasury or the Land and Water Conservation Fund receipts account, and the proceeds are not available for spending without appropriation.

Given these obstacles, it is little wonder that federal agencies have few properties that they are ready to declare to be excess. In FY 2000, agencies reported that they held only 200 excess properties valued at \$257 million. Of these, 10 properties were transferred to other federal agencies, 49 properties were donated to state and local entities, and 141 properties, valued at \$120.5 million, were sold. These are small numbers compared with the likely amount of property that is either vacant or no longer useful for the accomplishment of agency missions.

# Financial Assets

Financial assets of the federal government include direct loans and formerly guaranteed loans that the government has acquired after default. At the end of FY 2002, the federal government held \$248 billion in outstanding direct loans. That year the government wrote off \$729 million in defaulted direct loans and terminated \$15 billion in defaulted federally guaranteed loans that resulted in \$1 billion of loans receivable. Table 3 presents an overview of federal direct loans and the largest programs.

Financial assets of the federal government include accounts receivable, such as tax debts or defaulted federal loans, and current loans outstanding. Since the early 1990s the quality of federal management of financial assets has improved substantially. This resulted from several factors. First, the private sector made dramatic improvements in the application of technologies to the management of financial assets. The government was able to adapt some of these improvements for itself, such as technology-based loan origination and servicing systems, lender monitoring systems, and electronic data interchange. Second, the Office of Management and Budget (OMB), supported by the Financial Management Service of the Department of the Treasury, was instrumental in assisting federal agencies to share their experiences with one another and in promoting management improvements. Third, the Credit Reform Act of 1990 created an incentive for federal credit agencies to improve their management and reduce the losses from defaults and delinquencies. However, because of truly dramatic advances in the private sector, some government programs are subject to losing their

**Table 3: Direct Federal Loan Programs**  
(in billions of dollars)

Program	Outstanding 2002
Federal Student Loan Programs	99
Farm Service Agency (excluding Commodity Credit Corporation), Rural Development, Rural Housing	45
Rural Utilities Administration and Rural Telephone Bank	32
Housing and Urban Development	12
Agency For International Development	9
Export-Import Bank	12
Public Law 480	11
Commodity Credit Corporation	5
Federal Communications Commission Spectrum Auction	5
Disaster Assistance	4
Other Direct Loans	14
<b>Total Direct Loans</b>	<b>248</b>

Source: Office of Management and Budget, Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2004, Table 9-1, p. 214.

most creditworthy borrowers to private lenders. This problem, known as adverse selection, could leave some programs with an unacceptable proportion of borrowers who become delinquent or default on their federal loans.<sup>14</sup>

For the major category of financial asset, loans and loan guarantees,<sup>15</sup> major stages in the asset management cycle—analogue to stages in the cycle for other assets—include origination, servicing, collections on defaulted loans, and loan asset sales.<sup>16</sup>

## Loan Origination

For most federal credit programs, the origination of a loan involves the extension of credit on terms that a borrower would not be able to receive from the private sector without some form of federal support. It is difficult to underwrite federal loans to target eligible borrowers without also running the risk that an unacceptable number of borrowers will not be creditworthy. This makes it essential for government agencies to monitor the performance of lenders when they originate government-guaranteed loans. Otherwise, as has happened, a credit program could incur substantial losses from lenders whose up-front fees are high enough to make poor quality loans profitable to originate, even if the government then takes a loss on the loan.

The student loan programs have taken steps to reduce losses on their loans by monitoring the delinquency and default rates of schools whose students are eligible to receive direct or guaranteed federal loans. Other programs, notably the mortgage insurance program of the Federal Housing Administration (FHA) and the VA loan guaranty program, have seen their delinquency and default rates climb significantly over the past dozen years, compared with a substantial decline in delinquencies and defaults on private conventional mortgage loans, i.e., loans without federal support in the form of insurance or a guarantee.

One reason for the improvement in credit performance of some federal programs was the enactment of the Credit Reform Act of 1990. That act requires annual appropriations to cover the projected long-term cost to the government, commonly known as the subsidy cost, of direct loans and loan guarantees. The subsidy cost includes the present value of future expected credit losses plus the value of any interest rate subsidies, offset by the value of any fees that the agency receives for providing the loan or guarantee. The Credit Reform Act has led congressional committees and executive branch agencies to make changes to some credit programs so

that appropriated funds are used to pay for the extension of credit to an increasing number of borrowers by lowering the federal subsidies that attach to each loan or loan guarantee. Sometimes Congress and agencies have decided to tighten up on credit losses through improved credit management so that they can afford to spread their scarce appropriations across a greater number of borrowers. Alternatively, Congress has reduced the level of other federal support, such as subsidized interest rates, to stretch appropriations further, and this often tends to reduce credit losses.

## Servicing and Collection

Loan servicing is another important part of the credit management cycle. For direct loans, the government must provide servicing, often through contractors. For guaranteed loans, private lenders service the loans. Again it is important to monitor the quality of servicing by private lenders so that they take appropriate steps to ensure that loans remain current and do not become delinquent or default.

The direct student loan program, the largest federal direct loan program, appears not to differentiate servicing strategies according to the behavior of particular borrowers. The differentiated approach, familiar from private servicing, allows servicers to adopt the most effective techniques for ensuring timely payment by various kinds of borrowers. As a general rule, the lack of such a tailored approach to servicing can result in higher delinquency and default rates than otherwise would be the case.

Collecting on defaulted loans traditionally was difficult for federal credit agencies that do not like to be in a position of foreclosing or otherwise collecting from their constituents. Some programs, such as the student loan programs, now have adopted effective collection strategies. The Department of Housing and Urban Development (HUD) is currently engaged in a demonstration program, called Accelerated Claim Disposition, to use a joint venture structure (discussed later) to sell defaulted loans. This will allow the government to avoid holding the underlying properties during the long statutory foreclosure process that otherwise might apply. Other programs, such as the business loan guarantee program of the SBA, operate under new

statutory provisions that require the private lender to foreclose and collect on defaulted loans. The lender and the SBA then settle accounts according to the amount collected and the amount of the SBA guarantee. This is a far more effective mechanism than the traditional approach of allowing the private lender to put defaulted loans back to the SBA to foreclose on and collect from the borrower.

The Debt Collection Improvement Act of 1996 (DCIA) also has helped collections. The DCIA centralized the collection of delinquent nontax debt at the Treasury Department in two significant ways. First, it authorized Treasury to collect debts through a Treasury Offset Program. Under that program, Treasury compares the names and taxpayer identifying numbers of debtors with the names and numbers of recipients of federal payments. If there is a match, the federal payment is reduced, or “offset,” to satisfy the overdue debt. The DCIA requires federal agencies to refer delinquent nontax debts to Treasury for purposes of collection by offset. Currently, federal retirement, vendor, Social Security benefit payments, some federal salary payments, and tax refunds are being offset.

Second, the DCIA authorized Treasury to use other collection tools to encourage debtors to repay the federal government. Federal agencies are required to refer eligible nontax debts that are delinquent (over 180 days) to Treasury for debt collection action if they have not been successful at collecting those debts. Such debts include unpaid federal loans, overpayments or duplicate payments made to federal salary or benefit payment recipients, misused grant funds, and fines, penalties, or fees assessed by federal agencies. Treasury sends demand letters to debtors on Treasury letterhead and enters into repayment arrangements with debtors. Treasury also contracts with private collection agencies to provide delinquent debt collection services.

## Loan Asset Sales

Disposition is the last stage of the asset management cycle. Loan asset sales are a means of reducing the administrative burden on federal credit agencies. The SBA, for example, conducted an analysis in the late 1990s that showed that it cost the agency five times as much to liquidate a defaulted loan as it did to originate that loan. Moreover, the SBA was

in a position of having to manage a greater workload with less staff than before. In six years in the 1990s, the SBA’s annual loan volume expanded by 55 percent while staffing declined by 20 percent. Loan sales provided a means of removing labor-intensive defaulted loans from the SBA’s portfolio, thereby freeing agency resources to support loan origination.

From 1999 to 2002, the SBA conducted seven asset sales involving almost 169,000 loans with a combined unpaid principal balance (UPB) of \$5.9 billion. The sales returned \$3.7 billion in gross proceeds, with sales costs amounting to about \$170 million, or 4.6 percent of gross proceeds. The SBA suspended its asset sales program in early 2003 after GAO reported flaws in the credit scoring model used to compare sales returns with the cost to the government of holding the same loans. As Arnold S. Rosenthal, then the SBA’s assistant administrator for portfolio management, who led the office that was responsible for starting and managing the asset sales program, has pointed out, the pricing of asset sales provided the agency with better information about the value of its loans than it possessed from any scoring models used by the agency. However, until the models are made more accurate, it is unlikely that asset sales will proceed at the SBA. Other federal agencies that have engaged in large asset sales programs include the Resolution Trust Corporation (RTC), the federal agency that disposed of assets of failed savings and loan institutions after the thrift industry debacle of the 1980s, and HUD.

# Promising Practices in Federal Asset Management

A number of federal agencies display asset management practices that deserve governmentwide consideration. These promising practices range across the life cycle of federal assets, including acquisition, maintenance and operation, remediation, and disposition.

## **A Portfolio Approach to Acquisition: The United States Coast Guard (USCG)**

The USCG provides a model of a portfolio approach to asset management, in this case at the acquisition stage. The Coast Guard operates with a fleet that is aging and technologically obsolete. At the turn of the millennium, the agency's deepwater cutter fleet was the 39th oldest of 42 similar fleets in the world. Most of the ships in the Coast Guard's deepwater inventory were built between 1964 and 1972. Although some of these have been modernized, they operate with relatively large and expensive crews, are becoming more difficult to maintain, and do not incorporate modern technology. The Coast Guard determined that these deficiencies and shortcomings in maritime domain awareness, including command, control, communications, computers, intelligence, surveillance, and reconnaissance (C4ISR), were becoming unacceptable. Especially in the interdiction of maritime drug traffic, the Coast Guard found that it lacked an ability to spot drug smugglers or even to catch many fleeing vessels once they were spotted.<sup>17</sup>

In the late 1990s, the Coast Guard awarded three contracts for design of what the agency calls an

Integrated Deepwater System. In other words, the Coast Guard is taking a portfolio approach to its inventory of vessels, helicopters, planes, and other systems. In June 2002, the USCG awarded a contract to implement the first segment of the Integrated Deepwater System Program. The procurement's scale was bolstered by the impact of September 11 and recognition that the Coast Guard could not effectively support homeland security unless it replaced its obsolete fleet assets and systems. As currently envisioned the procurement program will involve a five-year base award term, with an option to award up to five additional five-year terms. The total procurement may amount to \$17 billion.

The USCG is implementing a "system of systems" approach in its procurement. The agency rejects the idea of trying to replace individual assets on a one-for-one basis. Instead the Coast Guard will acquire new types of assets that may be different from retiring assets but that will combine with the overall system of USCG assets to ensure coverage of all of the agency's mission needs. In other words, a helicopter may be retired and replaced by a vessel, or vice versa, if technological developments and the evolution of the USCG mission require the substitution, when all assets of the agency are taken into account. New forms of assets, such as unmanned aerial vehicles or leased satellite data, may substitute for older assets and activities. The result of this promising practice is that an agency such as the Coast Guard can avoid being locked into a pattern of replacing types of assets that may no longer be appropriate.<sup>18</sup> It will be instructive to follow this case study of the Integrated Deepwater System

Program as it is implemented over the coming years.

A critical question is the extent that the Coast Guard can manage the “system of systems” approach in the face of lower than projected allocations of budget resources and also the need to adjust to new priorities that reflect the agency’s role in the Department of Homeland Security.<sup>19</sup>

## **A Portfolio Approach to Maintenance and Operation: The Public Buildings Service (PBS)**

### **The Problem of Scarce Resources for Maintenance**

The PBS oversees 40 percent of all federal workspace, including 185 million square feet of federally owned space and 152 million square feet of leased space. The PBS has found itself chronically underfunded compared to the maintenance needs of the buildings that it owns. This has led to the backlog of buildings with serious repair and alteration needs, discussed previously. This case study shows the value of adopting a portfolio approach to asset management in maintenance and operation.

Traditionally the PBS tended to spread its available funds across a large number of buildings. Moreover, the regional structure of the PBS meant that there was a tendency to spread available funds across geographic regions. In preparing the program allocations each year, the PBS national office issued a call to the regions to submit projects. Regions then submitted their proposed projects, which the national office then ranked according to a set of criteria. The PBS then convened a panel consisting of regional and national office representatives to select projects, starting with the top-ranked project, and moving down the list to take as many projects as the available funding could cover.

This building-by-building approach had one strength: It ranked individual buildings in terms of priorities and allocated funds accordingly so that the highest priority buildings were maintained. This approach also had drawbacks. Most important, it failed to address the question of what to do with buildings that failed to receive an allocation of funds. Sometimes the regional offices would allocate

smaller amounts of money from other accounts, but often the only alternative was to defer maintenance and allow the buildings to deteriorate. Deterioration in turn caused a downward spiral. As the value of buildings declined, federal agencies either left for better space or, more often, obtained rent reductions commensurate with the loss of quality.

The PBS finally faced up to an unavoidable fact: Despite an urgent need for increased funding of building maintenance, alteration, and modernization, there was virtually no chance that the federal budget process would provide all of the needed funds; it is just too easy for budget policy makers quietly to defer maintenance and spend funds instead on government activities whose consequences are more visible to constituents. Over 11 years, 1991 through 2001, both OMB and Congress had made cuts in the PBS’s requested budget that averaged over 25 percent.

Once it was clear that the backlog of deferred maintenance would continue to mount, the PBS recognized the need to adopt a portfolio-wide strategy that would take account of the needs of more than the highest priority buildings. Analysis of the national portfolio revealed some important facts:

- Out of 1,753 buildings, the top 241 buildings, constituting 55 percent of the square footage (108 million square feet), produce 95 percent of the total funds from operations. The top 576 buildings produce 97 percent.
- Of the 963 buildings for which there are data, 443 buildings, with 46 percent of the rentable square feet, are over 50 years old.
- PBS funding levels are significantly below the benchmark set by the National Research Council for needed investments as a fraction of the aggregate inventory replacement value.
- Nearly two-thirds of the PBS-owned inventory consists of Class C properties (below commercial standards) in terms of the rent charged to the tenant agencies, even though some of those buildings are in Class A locations.

### **Applying a Portfolio Strategy**

Relying on these and other pieces of information, PBS portfolio managers developed a portfolio strat-

egy.<sup>20</sup> The goal of the strategy is to restructure the owned inventory to consist primarily of strong income-producing properties. This is to be done by limiting expenditures on marginal assets, concentrating resources on performing assets, and improving the quality of space for the PBS's federal agency customers.

Analysts developed two sets of measures of a building's performance. One set, called asset diagnostic measures, relies on simple criteria, as set forth in Table 4, and the second set relates to the financial performance of the property.

**Table 4: Asset Diagnostic Measures**

Criterion	Threshold
Vacancy	Building rate is within market vacancy plus 5%
Rental Rate	Building rate is within market range
Operating Expenses	Above industry normal range
Customer Satisfaction	Score is no less than 60%
Repair/Replacement Needs	Inventory Reporting Information System (IRIS) total is no less than 30% of Functional Replacement Value (FRV)

Using these “quick look” measures, the PBS can obtain a good picture of a building. Applying the measures to the entire portfolio allows the PBS to group buildings into three tiers and to indicate possible strategies for dealing with those buildings. The strategic plan presents the tiers as shown in Table 5.

Based on this triage, the PBS will seek to invest in the top tier of buildings, move buildings from the second tier either up or down, and cull third-tier buildings out of the inventory by sale or other disposition. The removal of third-tier buildings means that the scarce annual appropriations that are available for repair and improvement will need to be spread across a smaller number of buildings. PBS statistics show that third-tier buildings account for 20 percent of square footage in the owned inventory but 47 percent of all vacancies. They need \$1 billion in repairs and replacements and generate \$80 million annually in operating losses.

The PBS strategy takes account of the multiple values and constituent interests that attach to public buildings. It does not call for disposition of all poorly performing buildings. Rather, the plan recognizes that the PBS can afford to retain only a small number of financially marginal properties:

These fringe performers might consist of certain “heritage” properties for which federal ownership is a symbolic must, or certain properties where leasing is not a viable alternative. However, to over-subscribe this fringe set of performers is to risk perpetuation of the present dilemma: too few funds and too many buildings.<sup>21</sup>

**Table 5: Diagnostic Outcomes and Strategies for Public Buildings**

Tier	Diagnostic Outcome	Indicated Strategy
1	Predominantly good, including financials	<ul style="list-style-type: none"> <li>• Long-term hold if customer need is long term</li> <li>• Priority re-investment candidate</li> </ul>
2	Mixed	<ul style="list-style-type: none"> <li>• Explore third-party financing feasibility</li> <li>• Possible candidate for Federal Buildings Fund (FBF) re-investment if high yield prospect (for example, vacant space recapture)</li> </ul>
3	Poor	<ul style="list-style-type: none"> <li>• Limit capital expenditures to critical repairs</li> <li>• Third-party financing candidate</li> <li>• Disposal candidate</li> </ul>



The PBS has begun to implement its strategy. The agency has established a national watch list of seven different categories of buildings, including 92 buildings that are flagged as being in the process of disposition or exchange and 11 that have already been sold or exchanged. This compares with a total of 53 buildings that the agency disposed of in the six years spanning 1996 through 2001. The agency has ordered appraisals of properties in Tier 3 and the bottom part of Tier 2 and is posting statistics for regional actions on buildings.

Agency officials recognize that, in good part, they are working to change the values of their own agency. The first step was to convince PBS staff that the agency cannot anticipate any increase in federal funding and that the backlog of deferred maintenance would increase. The second step is to convince the regional offices that they will benefit from the strategy in the form of a restructured portfolio containing fewer but higher quality buildings. The PBS leadership, supported by OMB, is actively engaged in the task.

### **Property Cleanup and Disposal: Remediation of Rocky Flats, Department of Energy (DOE)**

The cleanup of Rocky Flats, one of the major facilities that produced weapons for the Cold War, provides a case study of successful application of important management techniques including (1) a clear focus on a single defined objective, (2) top-level support, (3) reservation of budget authority, (4) a collaborative approach with other agencies and stakeholders such as workers and local residents, and (5) performance-based contracting.

For almost 40 years the U.S. government used Rocky Flats for the manufacture and assembly of nuclear and nonnuclear weapons components and to recover plutonium. The nuclear mission of the site terminated formally in 1992, and the non-nuclear mission terminated in 1994. Rocky Flats is located about 16 miles from downtown Denver. Soil, groundwater, surface water, and many buildings on the site are contaminated with 14 tons of weapons-grade nuclear materials such as plutonium and uranium, toxic metals such as beryllium, and hazardous chemicals. The site consists of 6,300

acres, most of which are an undeveloped buffer zone around a half-square-mile industrial zone where the contamination is concentrated. About 200 out of 800 structures on the site (buildings, guard towers, and storage tanks) are radiologically or chemically contaminated, some severely.

DOE, through its Office of Environmental Management, has made Rocky Flats a priority for cleanup. Originally the department assumed a closure date of 2070. However, in 1997 the secretary of energy designated Rocky Flats and two other nuclear sites as pilot projects to be cleaned up and closed within 10 years. DOE and its contractor, Kaiser-Hill, then set an even more aggressive timetable of closure by the year 2006. In 2001, GAO expressed pessimism that DOE and its contractor could live up to the 2006 date. Nonetheless, GAO pointed to significant progress in the cleanup.<sup>22</sup> Dwight Ink, a fellow of the National Academy of Public Administration who has studied the Rocky Flats cleanup, reports that the accelerated closure effort has reduced cleanup costs substantially, from an original estimate of \$30 billion to a current estimate in the range of \$7.5 billion.

DOE accomplished its impressive turnaround at Rocky Flats by taking a number of important steps. First, the department focused explicitly on the cleanup mission. Paul Golan, chief operating officer for environmental management at DOE and a former official of the Rocky Flats site, states that the single most important step was to convince all parties, inside and outside DOE, that the mission of Rocky Flats had changed from an operations and maintenance culture to a project closure culture. Rocky Flats management worked tirelessly to drive the point home. One presentation, for example, was titled, "No further mission—Focus is on cleanup," to help make the point. Once the goal of closure was stated unambiguously and backed by consistent management over a number of years, the old culture, of assuming that one day Rocky Flats might again play a role in nuclear weapons production, finally gave way. At that point, all stakeholders, including federal employees and contractor staff, could concentrate their efforts on achieving that single goal. The focus on early closure also helped reduce overall costs. DOE had been spending \$400 million annually to maintain the security of Rocky Flats, to conduct intensive mandatory environmental inspec-

tions of radioactive physical plants, and otherwise to maintain and operate the aging facilities. The emphasis on closure allowed DOE to reduce these costs, especially for security, as the site was progressively cleaned up.

The second important step was to ensure support from the top of DOE. The cleanup process depends on support from other parts of DOE to provide casks for shipping materials and wastes and to ensure available sites for their disposition when they are sent from Rocky Flats. The Rocky Flats Closure Project Management Plan points to the critical role of the deputy secretary of energy as the senior government official for the closure project starting in the late 1990s. The new administration has been even more supportive. In speeches and testimony, Secretary of Energy Spencer Abraham has emphasized early closure of Rocky Flats and other sites as a major departmental priority. DOE's environmental management staff members find that they can call on top-level officials to help them obtain needed support from other parts of the department.

Third, DOE obtained the concurrence of key members of Congress, including members from Colorado, to establish a segregated budget account for the Rocky Flats cleanup. While this does not guarantee the needed multiyear funding, it does represent both an insistence that the work be done and a commitment that such funding may be available so long as the cleanup remains on track. Each year Congress has allocated increasing funding for the expedited cleanup account.

Fourth, the department brought the relevant stakeholders to the table to develop a common understanding of the technical basis for alternative approaches to moving forward with environmental remediation. In 1996, DOE signed an agreement with the U.S. Environmental Protection Agency and the State of Colorado's Department of Public Health and Environment, both of which have responsibility under environmental laws to ensure that the cleanup meets federal and state standards. This agreement helps define the end state of the cleanup process. DOE worked with the local community to articulate its cleanup goals and give local residents a chance to allay their concerns about the process and the final intended state of the site.

Fifth, DOE negotiated a performance-based contract with Kaiser-Hill. If closure takes place by the 2006 target date, DOE will pay Kaiser-Hill about \$4 billion for its costs. In addition, Kaiser-Hill will receive a fee, which could be about \$340 million, but that can vary from \$130 million to \$460 million, depending on the contractor's performance in terms of timeliness and cost savings. Under the contract, for example, Kaiser-Hill is entitled to recoup 20 percent of cost savings compared with a baseline amount. However, DOE penalizes the contractor for safety violations according to a scale that relates the severity of violations to the consequences, including potentially large penalties for major violations.

Negotiating the performance-based contract had positive consequences. The contractor has been motivated to perform well. Kaiser-Hill signed a collective bargaining agreement with the affected labor union to help align the incentives of its workforce with the goals of rapidly closing the site.

Moreover, the substitution for performance in place of the past process-based approach has meant that DOE could reduce the size of its federal workforce at Rocky Flats. DOE officials point to excess staff as a cause of difficulty, especially because staff in the past would request the contractor to undertake tasks that did not necessarily contribute to the larger cleanup effort. With clear performance standards in place, a smaller number of DOE staff could monitor the essential issues and leave less important decisions to the discretion of the contractor. (The value of aligning incentives between the government and its contractors also is a lesson of the next two case studies, in the quite different context of asset sales.)

Rocky Flats plays an important role in DOE's approach to other impaired assets, such as the facilities at Fernald and Mound in Ohio that the department holds. It is the largest and most challenging nuclear decommissioning project slated for early completion. DOE considers that the application of lessons from Rocky Flats will be an essential part of the process of safely cleaning up other parts of the DOE weapons complex.

## Selling Loans and Real Property: The Resolution Trust Corporation (RTC)<sup>23</sup>

The savings and loan debacle involved the failure of thousands of federally insured thrift institutions. In 1989, the government created the RTC as a temporary federal agency that would reorganize or wind up the failed institutions, pay off depositors, and sell the recovered assets to private investors. The RTC was a federal corporation with a statutory charter that expired on December 31, 1995. It operated under a mandate to sell assets without a federal guarantee or other recourse to the federal government. The RTC provides a case study of the value of taking a portfolio approach to asset disposition, backed by a process of continuous learning and process improvement.

The RTC did a remarkable job. In roughly six years of operation, the agency disposed of a wide variety of assets, including performing and nonperforming loans and land, houses, commercial properties, and other collateral with an aggregate book value of \$455 billion, leaving some \$8 billion (book value) in its inventory, plus another \$6 billion in credit reserves. Recoveries from sales and collections averaged 87 percent of book value and totaled about \$395 billion. The RTC sold most of its assets, including whole loans, through competitive sales and sold some \$42.4 billion of real estate loans as asset-backed securities.

### The RTC and Continuing Process Improvement

The RTC provides an impressive example of an organization that learned from its experiences and constantly evolved improved processes and programs. The agency used increasingly effective structures for asset disposition that show clearly the tradeoffs between sound design and ease of effective implementation.

Thomas Horton, formerly a senior RTC official, commented on the RTC's approach:

The RTC was clearly a laboratory for experimenting with various asset management and disposition strategies. In fact, we embarked on numerous tracks in an effort

to sell the assets and at the same time maximize recovery.<sup>24</sup>

The RTC was able to sell the most marketable mortgage-backed securities and loan assets in bulk sales. For the lower quality assets, the RTC then experimented with a progression of approaches, beginning with familiar techniques such as contracting out asset management and disposition responsibilities. The problem was that, once the private asset managers sold the most salable assets, they collected a monthly fee for overseeing the rest of the assets that remained government property. This monthly fee discouraged contractors from making special efforts to sell the more difficult properties. The conflicting interests of the RTC and its asset managers meant that the RTC had to try to supervise its asset managers to ensure their compliance with their contract with the government, known as the Standard Asset Management Disposition Agreement (SAMDA). This supervision imposed great demands on the agency's institutional capacity. Moreover, government officials often were tempted to substitute their own judgments for those of the private asset managers. Sometimes the results could be quite burdensome.

Agency officials soon realized that traditional approaches were inadequate to deal with the huge number of difficult assets in RTC hands. They saw how some purchasers made considerable money by securitizing pools of RTC assets and decided to securitize low-quality assets themselves. The RTC structured its securitizations to sell equity shares to private investors who would actually dispose of the assets in return for a specified percentage of the cash flows, and also to sell debt obligations based on the pool of assets. To achieve a high investment grade rating on debt securities backed by pools of nonperforming loans, the RTC retained a sizable residual reserve fund for each pool.

The purchasers of the equity part of securitized assets found that they could increase their returns by disposing of the assets much more quickly than anyone had expected. This meant that the RTC's asset-backed securities paid off very quickly. Because of the high cost of underwriting and rating securities, securitization seemed expensive for assets that paid off within perhaps two or three years.

RTC officials then experimented with equity partnerships. In 1994 and 1995 transactions, the RTC divided the securities backing a pool of assets into two parts. Private parties bid competitively for the right to manage the pool and received Class “A” securities that entitled them to receive a specified percentage of the cash flows. The RTC retained Class “B” securities for itself and reserved the right to sell these to investors at a later date. In effect, the RTC provided seller financing by keeping a large ownership stake in the pool of assets. The equity partnership thus kept the form of a securitization but altered its substance.

The RTC established fairly rigorous standards for the qualification of bidders, including a performance track record and capital requirements. The winning bidder became the general partner and the holder of a Class “A” certificate that represented a specified (often 49 percent) equity interest in the partnership. The winning bidder was compensated through its share of returns from the sale of assets or income from the assets and, usually, a servicing fee of 1 percent of the principal balance of assets remaining in the trust.

The final step in the evolution of the RTC’s approaches to asset disposition was the joint venture partnership. The joint venture partnership was designed to give the private partner a significant minority share of the cash flows from the sale of the assets, but to strip out any other interests of the private partner that could complicate the incentive structure. The partnership agreement permitted no payment of a servicing fee and also limited any ability of the private partner to receive tax advantages from the transaction.

The private partner became the general partner with all rights and responsibilities to manage and sell the pool of assets. The RTC was the limited partner, with rights to receive a proportionate share of the cash flows and a proper accounting of all transactions, but essentially in a passive role.

The RTC created some 40 to 45 partnerships to dispose of about \$16 billion of assets. The agency successfully used the joint venture structure to sell a broad range of assets, including real estate and real estate loans, nonperforming loans, and even

some extremely low-quality assets in the form of judgments, deficiencies, and collections.

### **The Special Case of Environmentally Impaired Assets**

One type of asset sale deserves special mention. This is the RTC sale, through joint venture partnerships, of loans secured by properties that were likely to be environmentally impaired.<sup>25</sup> The sale of such loans, or of real property, is possible for assets with positive net value but with environmental impairments that could deter investors from paying full value. (In other words, the type of sale described here is not a useful tool for cleanup of a property with substantial negative net value such as Rocky Flats because no one would be willing to buy it; in such a case, the government needs to pay for the cleanup directly.)

Investors fear to purchase environmentally impaired properties because the losses on such properties could turn out to be catastrophic. The purchased property then would change from an anticipated asset into a substantial liability. However, the government may achieve faster and more effective environmental cleanup if it places the property in the hands of a private party that has an incentive to remediate the environmental damage.

Properly structured, the joint venture provides one way to deal with the need to sell environmentally impaired assets. In one case, for example, the government assembled a pool of impaired assets of varying quality. A pool offers diversification to increase protection for bidders against purchasing loans and properties that are completely unprofitable.

The government set a ceiling of \$50 million in the amount that the joint venture would be expected to pay for remediation of all the assets in the pool. If remediation of the environmental impairment reached the \$50 million ceiling, then the government had to choose either to repurchase the impaired assets or to pay for the extra costs of the cleanup above the \$50 million ceiling.

The joint venture was structured to give the private partner a 20 percent right to cash flows from the sale of properties to third parties; the government received

80 percent of the cash flows. By retaining most of the financial interest in the assets, the government could protect itself from overly discounted bids.

The net result was an incentive for the private partner, so long as it believed that remediation costs were below the \$50 million cap, to clean up properties as inexpensively as possible and to sell them, as a way to maximize the value of the pool of assets. But if the costs of cleanup started to near the \$50 million ceiling, the private partner would be protected from catastrophic loss by the terms of the partnership agreement. Such protection means that the government will receive higher bids from private firms seeking to be the joint venture partner, since the bidders will not need to discount their bid prices to compensate for the risk of catastrophic loss.

### **The RTC's Valuable Legacy**

As the RTC disposed of its assets, the market began to develop. RTC officials could watch the range of competitive bids become tighter as an increasing number of private investors perceived the value of assets that were below investment grade and sought to purchase RTC assets. Private bidders also began to appreciate the structure of RTC transactions and to bid more competitively on the right to become the equity partner and dispose of RTC pools. By aligning the incentives of the private joint venture partner with those of the government, the RTC was able to harness the efforts of the private partner to provide value to the government as well. This was a very efficient structure that required much less oversight than the original SAMDA process and some of the other approaches that the RTC had tried.

Today, as a direct consequence of the RTC's work, the private market has become increasingly efficient at trading so-called "B" and "C" quality (that is, below investment grade) residential mortgages. The RTC's work also helped create a competitive market for other federal agencies, including HUD and the SBA, when they began programs to sell loan assets. HUD's recent Accelerated Claim Disposition demonstration initiative is a promising variation on the RTC's joint venture approach.<sup>26</sup> Relying on advisers who had gained experience as contractors for the RTC, the Defense Reutilization and Marketing Service (DRMS) also could build on the RTC experience.

### **Sales of Excess Personal Property: The Defense Reutilization and Marketing Service (DRMS)<sup>27</sup>**

DRMS is the DoD agency responsible for disposing of property that DoD considers to be excess for reasons such as changing technologies or priorities, outdated inventory, or closure or downsizing of military installations. Under the law, excess DoD property is subject first to reutilization within the department, then to transfer to other federal agencies, and finally to donation to state and local governments or eligible nonprofit organizations. In FY 2000, DoD distributed about \$4 billion of excess property through reutilization, transfer, or donation.

Property that remains is considered surplus and is sold by DRMS either for scrap or for private use. DoD's surplus property includes a stream of surplus assets, such as machine tools, hardware, bearings, electrical and electronics equipment, material handling equipment, service trade equipment, aircraft parts, vehicles, clothing and textiles, medical items, furniture, commercial kitchen equipment, and many other kinds of property.

Traditionally, DRMS conducted hundreds of surplus property sales monthly at more than 100 sites throughout the country. DRMS turned to the RTC joint venture structure to provide the basis for designing a more efficient sales process that would yield better returns with less administrative burden on the shrinking agency. Financial advisers helped DRMS adapt the joint venture structure to DRMS's unusual needs. The RTC had used the joint venture to sell pools of assets that were specified in advance and that purchasers could examine before making their bids to become the RTC's joint venture partners. By contrast, DRMS does not know what kinds of military property might become surplus and available for sale at any particular time. DRMS needs to sell a future flow of assets rather than fixed pools. Thus, DRMS adapted the RTC joint venture structure to create the first "pipeline" sale of a future asset flow.

DRMS created a new asset sales structure called the commercial venture (CV). In the commercial venture, DRMS finds a private purchaser who pre-commits to purchase all usable property that

becomes surplus in designated locations over a specified period of time. To help bidders decide how much to bid, DRMS segregates property by category and publishes information on past sales of each type of property. It turns out that the average sales price of surplus usable property may be perhaps 1 to 2 percent of the acquisition value. The winning bidder is expected to sell the property that it purchases. The firm is required to form a “stand-alone” corporation whose sole business is the processing of DRMS property. All costs directly associated with that processing, such as transportation, storage, refurbishment, and marketing, are paid from resale proceeds. The government then receives 80 percent of the net resale proceeds, and the CV firm receives 20 percent.

DRMS conducts a two-step sealed bid process to find its CV partner. In the first step, DRMS solicits proposals that demonstrate the bidders’ qualifications to sell large volumes of surplus property. In the second step, DRMS solicits the qualified bidders to bid the price at which they will precommit to purchase the flow of assets over the term of the contract.

DRMS awarded its first CV contract in July 1998 and its second in June 2001. The agency expects that some \$23 billion in equipment (the acquisition value, not the sales price) should flow through the new CV contract over its seven-year term. DRMS estimates that it has saved millions of dollars a year in sales costs from the existing commercial venture, besides the savings that resulted from a reduction in the agency’s administrative burdens so that it can carry out its mission despite the downsizing of its staff.

The DRMS case shows how the adoption of new business processes, here for disposition of hard-to-sell assets, can reduce the administrative burdens on a federal agency. Again, the alignment of incentives between the federal government and its contractors is the key to reducing the amount and intensity of oversight that is required to ensure performance.

# Findings and Issues

## Findings

Some common themes run through these promising practices. First, asset management on a portfolio-wide basis can be essential to the success of a program. This is true at virtually any stage of the asset management cycle. The Coast Guard adopted a portfolio strategy for its fleet acquisition, the PBS for maintenance and operation of federal buildings, and the RTC for asset disposition. The driver for a portfolio strategy is the need to allocate scarce resources to the most beneficial purposes. In the case of the Coast Guard, it makes no sense to acquire a vessel or airplane if an unmanned surveillance aircraft or space on a satellite can provide greater benefits for less cost. In the case of public buildings, allocation of resources to the highest priority buildings was insufficient until the agency's strategy also considered the other part of the portfolio, which received few or none of the available funds. A portfolio strategy is the only way to optimize conditions for the entire portfolio. Moreover, the use of a portfolio strategy forces the agency to include the most difficult assets in the management strategy. As in the case of the SBA, which found itself extending increasing volumes of credit while being downsized, asset disposition may be a useful part of the agency's repertoire.

A second theme is the need to structure the relationship with third parties such as contractors so that the incentives of the government and the private party are aligned. The RTC provides a remarkable example of an agency that evolved its relationships to increasingly efficient forms. The RTC began with the hiring of management and marketing contractors

and found that it was expending considerable resources on oversight and auditing. The agency experimented with other relationships such as equity partnerships and finally devised a joint venture structure that allowed the private partner to make considerable returns, but only if the government's returns were commensurate. DRMS was able to build on the RTC experience to achieve a similar alignment of the government's interests with those of its commercial venture partner.

DOE's experience at Rocky Flats reflects the same lesson. Once DOE renegotiated the Kaiser-Hill contract to become performance based, DOE was able to reduce the federal staff that had been used to oversee the contract in the past. Kaiser-Hill may do well financially under the contract, but the performance standards mean that DOE will benefit as well from more rapid progress and reduced costs.

Rocky Flats also provides another important insight. Asset management is greatly simplified if the government can state a clear objective with respect to a particular asset. The DOE and contractor staff at Rocky Flats marked time for years until DOE sent and reinforced a clear message: "No further mission—Focus is on cleanup." Until then, work was slow because of confusion about whether Rocky Flats was standing by for some resumption of its past mission or whether it was time to clean up and close down. DOE could not do both.

The RTC faced similar challenges at the beginning of its work. For example, was the government supposed to use the properties it held for public pur-

poses such as providing affordable housing or was it supposed to sell everything to the highest bidder? The RTC resolved that particular dilemma by bifurcating its portfolio. Some properties were allocated for disposition in a distinct affordable housing program while the bulk of the properties were sold at market prices to offset losses to the taxpayers who bore the costs of the savings and loan debacle.

These examples lead to a third lesson: Leadership from the top is essential to help an agency to make such hard strategic decisions, especially if they involve new ways of doing business. Virtually all of the case studies presented here—Coast Guard, PBS, Rocky Flats, RTC, and SBA—reflect the involvement of top agency leaders in managing for success. Mid-level officials simply lack the position in the organization to bring all the players together and move them in a common direction. Indeed, the one issue that arises from the Rocky Flats project is a concern that other parts of DOE may not provide the necessary support and equipment for shipping radioactive wastes to other sites for burial. If these organizations fail to cooperate, Kaiser-Hill will not be able to complete its work on time.

Finally, asset management is a dynamic process—the world is not standing still. Sometimes this is costly. For example, the Public Buildings Service finds that some elegant old buildings cannot easily be wired for new technologies. Many times, change is beneficial. For example, the Coast Guard can use new technologies such as unmanned aircraft or new types of radar to substitute for older assets, and the RTC, the SBA, and DRMS can use new financial structures to sell their assets and can use technologies such as document imaging and the Internet to facilitate sales. The pace of change is affecting most parts of the asset management process; however, the applicable laws and regulations and budget scoring rules do not adapt nearly as quickly.

## Issues: Constraints on Effective Federal Asset Management

Statutory and regulatory constraints on effective asset management include budget disincentives and the provisions of the Federal Property and Administrative Services Act of 1949. Other constraints include countervailing constituency con-

cerns that complicate the process of finding a single strategic focus for an agency's asset management.

### Issue One: Budget Disincentives

The federal budget is a means of determining how to allocate scarce federal resources across competing demands for those resources. Because Congress appropriates funds annually, most programs keep their books on an annual basis. While budget scoring rules are important tools to assist Congress in allocating public resources, they are seriously deficient in dealing with the interface between government and the private sector.

This deficiency manifests itself both in asset acquisition and in asset sales. Take acquisition first. Under the Budget Enforcement Act of 1990, a federal agency must score an amount equal to the government's total legal commitment in the year that the commitment is incurred. In other words, if an agency enters into a contract to buy a building, it must score the entire cost of that commitment in the first year, even though the benefits of the building may last for decades.

By contrast, if an agency enters into an operating lease for a building, it may score the annual payments in the year that they are made, year after year, for the duration of the lease. In OMB Circular A-11, OMB has adopted limits on the extent that operating leases may be used to mask long-term occupancy commitments, but these rules have been increasingly circumvented.<sup>28</sup> For example, OMB is said to assume that an agency's operating lease for a building contains a clause permitting termination for the convenience of the government, even though such a clause may not be present in a legally binding form. The government then ends up entering into short-term lease arrangements, even though it may need the space for a longer period of time.

The consequence of this disparate budget treatment has been to force federal agencies, which are unlikely to have an annual appropriation that is sufficient to fund either the complete construction or purchase of a new building or a long-term lease, into more costly short-term lease arrangements. The source of this conceptual difficulty is the fact that the public and private sectors face quite different



cost structures. The federal government, with its access to low-cost Treasury borrowing and its general freedom from tax obligations, can fund a long-term acquisition such as a building much less expensively than can a private firm. Beside needing to pay much higher financing costs than the government, a private firm also must pay returns on its equity and must make tax payments.

A common sense approach would be to charge a government agency its construction costs for a new building at the borrowing costs available to the federal government. However, the focus of the federal budget on the annual allocation of resources discourages this approach by requiring that the costs of a building be appropriated and budgeted in the year that the federal agency enters into a binding commitment to purchase or construct the building. The result is that the government increasingly relies on shorter term lease arrangements that include much higher private financing costs, merely because those lease payments may be scored year by year over the life of the lease, rather than up front in a single year.

The General Accounting Office has suggested alternative solutions to this problem. Congress might create capital acquisition funds that would allow federal departments to borrow from the Treasury to allow their constituent agencies to fund purchases of major assets. Agencies within the department would repay these loans, with interest. The result would be that agencies could pay for acquired assets over their useful lives, and thereby afford to purchase or construct buildings rather than lease them through more expensive multiple short-term leases.<sup>29</sup> Alternatively, and probably less easy to implement, Congress could require agencies to score up front all long-term leasing (including multiple short-term lease arrangements) so that lease-or-buy and lease-or-build decisions would be made according to the best value to the government. To deal with the problem of large up-front costs, Congress would then adjust the existing budget caps to accommodate the change.<sup>30</sup>

Another problem relates to the incentives for an agency to sell or exchange federal property. Gains from a sales transaction accrue to the treasury and other receipt accounts, and are not available for spending by the agency that sold the property. Yet

the costs of a new acquisition, or of maintaining and upgrading existing facilities, require new appropriations by Congress. This disconnect precludes agencies from using sales and exchanges as means of upgrading the quality of their facilities. On the other hand, as was discussed earlier, any changes to the budget rules must be made with caution because of the possibility of unintended adverse consequences.

Comparable disconnects occur in the scoring of sales of financial assets. While credit budgeting generally has had beneficial effects by promoting improved management of federal loan assets, the SBA's experience, described previously, highlights how budget scoring rules have been counterproductive for loan asset sales. To sell loan assets, a government agency must compare the price received from the sale with the so-called "hold value," or value of the assets in government hands. This is a reasonable requirement. However, the budget scoring rules apply a double standard. The purchase price of sold assets includes the cost of funding those assets at private sector rates of interest and private costs of capital and payment of taxes. By contrast, the government's "hold value" is calculated on the basis of much lower costs of government borrowing at Treasury rates, without considering the costs of capital or tax burdens that apply to private purchasers of federal assets. That makes the private purchase price look much less favorable than if the same yardstick were applied to both the public and private sectors for purposes of deciding whether the transaction price is favorable. Moreover, the budget scoring rules make it difficult if not impossible to include the government's administrative savings in the calculation of whether the sale is advantageous, even though a private purchaser will bid a price that includes a calculation for administrative costs.

Especially for federal credit agencies, budget scoring rules may preclude the government from making economically beneficial decisions, such as selling performing direct student loans. When the government sells nonperforming loans, such as in SBA asset sales, considerable gains in value are possible from improved servicing and loan administration when the loan assets move into private hands. However, performing loans are current in their payments and therefore will not show the kind of gains in

value that are possible from private servicing and collection on nonperforming loans. Even though large-scale sales of direct student loans would save the Department of Education an immense administrative burden, such sales are not possible without a change in budget scoring rules. Budget rules also discourage some public–private financial risk sharing arrangements that otherwise might be quite beneficial.

In other words, because the government and private sectors keep their books quite differently, both real property acquisitions and loan asset sales that may be very cost effective from a management perspective, and some other potentially useful public–private transactions, may give the appearance of lost value. As one government expert observes about asset sales:

[I]t is clear that none of the government’s existing accounting or budgetary measures of value are suitable for evaluating the desirability of a proposed asset sale. Thus, it is unlikely that any procedural rule based upon existing budgetary or accounting measures would be capable of distinguishing accurately those asset sales that are harmful to the government’s interests from those that are not.<sup>31</sup>

Finally, as also happens in sales of real property, a government agency must pay the costs of preparing a loan asset sales program up front, and may deduct the costs of the sale only after the sale takes place. The need for up-front appropriations makes it very difficult for agencies to begin loan asset sale programs, even when substantial benefits are likely to result for the government, such as allowing a federal credit agency to manage increasing volumes of loans during a period of downsizing.

### **Issue Two: The Federal Property and Administrative Services Act of 1949**

The Federal Property and Administrative Services Act of 1949 governs the disposition of real and personal property by most federal agencies. As it stands today, after considerable amendment, many of its most significant provisions apply to property disposition. Among its relevant provisions, the act requires each executive agency (1) to maintain ade-

quate inventory controls and accountability systems for its property, (2) to survey its property continuously to determine which is excess to its needs and promptly report excess property to the GSA administrator, (3) to care for such excess property, (4) to transfer or dispose of such property in accordance with authority delegated and regulations prescribed by the administrator, and (5) to reassign property among activities within such agency, to transfer its excess property to other agencies, and to obtain for its use property that is excess to the needs of other agencies. The act provides for the transfer of surplus personal property to state agencies and also for the disposition of property in unique ways by executive departments that are named in the act. Finally, the act provides that proceeds from disposition of property shall be deposited into the treasury. A provision of another law provides for depositing those funds in the Land and Water Conservation Fund administered by the secretary of the interior to assist communities in acquisitions of public park and recreational facilities.

The act neglects to provide to federal agencies many types of authority that might be useful, such as authority (1) to lease out excess space to private tenants, (2) to exchange personal property for other property or for services that might substitute for such property (for example, disposing of a computer system and purchasing data processing services instead), or (3) to exchange or transfer real property with other federal agencies and enter into agreements with nonfederal organizations to exchange or sell property as a means of acquiring more suitable replacement property. Perhaps most important, the act does not authorize agencies to use the proceeds of property sales to offset all costs of disposition or, in the case of real property, to retain some of the proceeds for purposes of improving an agency’s facilities. In the words of Stephen Perry, GSA administrator, who has been urging the enactment of the property management and disposition parts of the president’s Freedom to Manage legislation,

[W]e would like to see the existing property management statutes more accurately reflect the current needs of the government and emerging practices of the commercial marketplace. This will help agencies achieve

their mission goals by reducing the amount of deteriorated, vacant and underutilized space in the existing Federal real property inventory.<sup>32</sup>

While there can be reasonable differences about the extent that current restrictions should be relaxed, there is little doubt that some modernization of the Property Act is called for.

### **Issue Three: Countervailing Constituency Concerns**

The framers of the United States Constitution designed a system of government that is responsive to constituency concerns, including those that might represent values other than pure economic efficiency. The result for federal asset management is that, as GAO observes with respect to real property:

As a result of competing stakeholder interests, decisions about real property do not reflect the most cost-effective or efficient alternative that is in the interest of the agency or of the government as a whole, but instead reflect other priorities.<sup>33</sup>

GAO points out that the influence of countervailing interests affects the spectrum of asset management activities, including the location of federal facilities in particular states or congressional districts and resistance to efforts to consolidate or close underutilized federal offices and dispose of unneeded assets.

In other words, even if budget scoring rules were changed and agencies were given expanded authority under the Property Act and other laws, constituency interests will continue to affect the extent that particular government agencies will be able to benefit. For example, in concept at least, the budget scoring rules that constrain acquisition of public buildings through purchase or construction do not apply to government corporations that operate on a financially self-sustaining basis. Under the Government Corporation Control Act, these government corporations are supposed to keep their books according to GAAP (generally accepted accounting principles) and submit business-type budgets each year. The submission of a business-type budget allows many such corporations to make multiyear investments of funds to increase

their returns.<sup>34</sup> This budget treatment is justified because a financially self-sustaining government corporation does not compete with other government agencies for scarce appropriated funds. One consequence of the business-type budget is that organizations such as the United States Postal Service should not face the constraints of appropriations laws and the associated budget rules when they purchase property. The USPS is also not subject to the provisions of the Property Act. Nonetheless, as was discussed previously, other laws and constituency concerns constrain the USPS, especially when it attempts to consolidate or close unneeded mail facilities. As an organization with the attributes of a government corporation and a favorable charter, the USPS is much freer in theory than in practice to streamline its operations and rationalize its assets.

That said, it is clear that careful changes in governmentwide budget scoring rules and provisions of law such as the Property Act can have a significant favorable impact, even if individual agencies will need to defer to particular kinds of constituent interests. The advantages of the changes in law that created the Federal Buildings Fund and that resulted in credit reform have already been mentioned. Given the complexity of the issues, it would be beneficial, as the General Accounting Office has suggested with respect to real property, to convene an independent commission or a governmentwide task force to develop a comprehensive and integrated asset management strategy for the federal government.<sup>35</sup>

# Recommendations

The management of federal assets, and especially real property assets, is in need of improvement, and a few basic reforms could be of great help. Four reforms stand out: reform of budget rules, adoption of a portfolio strategy by major federal asset holders, creation and support of interagency working groups, and experimentation with new lease arrangements.

## Recommendation 1: Reform Budget Scoring Rules

In contrast to the adjustments needed in budget scoring for acquisition of buildings and real estate, which require legislation, OMB by itself can make changes in scoring to remove artificial barriers against loan asset sales. OMB would need to amend Circular A-11, which prescribes scoring for agency budget submissions, to require calculation of the “hold value” of the loan assets, compared to the sales price, by using a discount rate that reflects the private sector’s cost of funds rather than the government’s lower financing costs. This would permit the sold assets to be valued by a common yardstick that does not, as at present, artificially discriminate against a sale.

OMB has discretion to take such a step. Indeed, Appendix A to Circular A-11 contains an artificial factor to try to equalize the sale of nonfinancial assets by changing the discount rate used to calculate the hold value. For nonfinancial assets, Circular A-11 requires that the government’s discount rate be calculated at the Treasury rate of borrowing plus 2 percent. As the circular explains, the two extra

percentage points have been added “to reflect the economic effects of continued ownership.” It is time to apply a similar adjustment that is sufficient to remove the scoring discrimination against cost-effective loan asset sales.

## Recommendation 2: Adopt a Portfolio Strategy for Major Federal Asset Holders

Federal agencies that hold significant amounts of property need to adopt a portfolio strategy for acquisition, maintenance and operation, and disposition. The development of such agency strategies does not necessarily require a massive investment in information, although some commentators have recommended this. Rather, many agencies may be able to devise “quick look” diagnostic measures that provide the information needed to make intelligent decisions about the property that they hold, acquire, or dispose of. The lessons of the Coast Guard and Public Buildings Service cases provide ample support for the proposition that agencies need to take a portfolio perspective on federal assets.

## Recommendation 3: Adopt a Life-Cycle Approach to Managing Federal Assets

Federal agencies would do well to consider and plan for the operations, support and disposal costs associated with government assets starting before asset acquisition or origination and continuing through the entire life of the asset. It is not unusual

for maintenance costs of an asset to far exceed the initial acquisition costs or for unanticipated servicing costs to exceed the value of the asset. As the Department of Education discovered at one point, the costs entailed with servicing a federal student loan can exceed anticipated federal interest revenue if not carefully planned. The cost of disposing of an obsolete naval vessel can exceed the cost of a new vessel if disposition is deferred for too long. The effort to develop and implement a forward-looking asset strategy and to manage an asset appropriately throughout its life cycle should not add cost or take additional time. On the contrary—total asset life-cycle management can be largely accomplished through a disciplined application of common sense business practices that will ultimately save the taxpayers considerable resources.

#### **Recommendation 4: Create Interagency Working Groups Supported by the OMB Deputy Director for Management**

The Federal Credit Policy Working Group was an interagency group of federal credit agencies that convened monthly under the auspices of OMB's deputy director for management. The working group benefited from the active involvement of a senior OMB management official, the senior adviser for credit and cash management, who provided an institutional focus for agencies seeking support in enhancing their credit management practices.

Over the decade of the 1990s, the working group provided a forum in which agencies could share experiences and improve their coordination on projects of mutual interest. In 1996, for example, the Federal Credit Policy Working Group and Treasury's Financial Management Service (FMS) cosponsored a promising practices workshop that allowed agencies to showcase their progress and learn from other public and private organizations about developments in key management areas such as loan origination and servicing and lender monitoring.<sup>36</sup>

The Federal Credit Policy Working Group has now largely dissolved as a means of promoting interagency development of improved practices. Also, except for its administration of debt management

services, the FMS has lost interest in supporting the improvements in practices by federal credit agencies. Yet, the experience of the federal credit agencies provides a valuable model for making progress on asset management issues.

Most important, it is time to consider creating a federal real property working group under the auspices of the OMB deputy director for management. This group would be charged with elevating the importance of real property management within the executive branch and with encouraging the linkage of real property planning to agencies' strategic plans. A group with a similar mission, the Federal Real Property Council (FRPC), has existed for six years under the leadership of GSA's Office of Government-wide Policy (OGP) and might form the basis for building the membership of the new working group. The deputy associate administrator for real property in GSA's OGP, who chairs the current FRPC, might serve as the principal supporting official to the OMB deputy director for management for the expanded working group.

The lifting of real property issues to the deputy director level at OMB will give them a higher profile than is possible through today's FRPC. While the FRPC has been successful at elevating certain critical issues, such as the need for real property reform legislation, to high visibility within the administration and Congress, sponsorship and support from the OMB deputy director for management can give a level of stature and strength that the GSA-led group cannot achieve on many other issues.

Moreover, given the continuing need for shared learnings about improved practices by the federal credit agencies, it also would be beneficial to create a new forum for management of financial assets and again to involve the FMS in supporting management improvements. It is unwise for OMB and FMS to concentrate their efforts on the back end of the asset management cycle—loan collections—without playing a more constructive role earlier in the cycle, and especially to help foster enhanced risk management practices for federal credit agencies in loan origination and servicing.

## **Recommendation 5: Experiment with New Lease Arrangements**

It is not clear whether some federal agencies have the capacity needed to hold their own in transactions that involve new types of lease arrangements such as outleasing excess space, exchanging property with private parties or state and local governments, or using public-private partnerships.<sup>37</sup> In contrast to a government agency, a private firm may have much better information about the value of the property involved and other important factors. Also, agencies need to be protected against pressure to use transactions with their available facilities as a means of making up shortfalls in their annual appropriations. Yet, federal agencies cannot continue to sit on excess and deteriorating space without the ability to dispose of it in a reasonable manner.

GAO proposes a reasonable approach to relaxation of some of the limitations of the Property Act: The federal government should conduct a limited number of experiments with a controlled relaxation of some Property Act requirements.<sup>38</sup> It may be possible, for example, that GSA could employ private real estate services to provide the necessary market information for an agency that would benefit from outleasing or exchanging space. Other experiments might involve providing federal agencies with a limited ability to share in gains from disposition of deteriorating buildings, say, that rank in Tier 3 according to GSA's asset diagnostic measures, described in Tables 4 and 5. Congress has considered legislation along these lines.

Adoption of these recommendations would go far toward removing the most serious impediments to effective federal asset management and to preparing the way for the more extensive changes that may be needed. Improved asset management can free federal agencies to carry out their public purposes more effectively and in an improved workplace environment.

# Appendix I:

## Research Agenda

At least six research topics would be appropriate for further exploration:

### **Principles of Asset Portfolio Management**

One of the lessons of the federal agency experiences recounted here is that asset management is much more effective when conducted on a portfolio basis than by looking only at individual assets or groups of assets. Further research can present a broader range of government experience including lessons about effective approaches to portfolio management. For example, GSA used “quick look” measures to analyze its portfolio rather than attempting to generate the large volumes of comprehensive data that the National Research Council and others have called for. Effective management involves application of such useful measures to support sound management decisions, even if ideal forms of information data are not available. The purpose of this research will be to highlight strengths, limitations, and effective approaches to portfolio management as a tool for agencies and asset managers across government.

### **Budget Rules at the Public-Private Interface**

Budget rules have proved their value as tools for allowing policy makers to allocate scarce resources across government organizations and public purposes. Budget rules are less helpful, and indeed can be counterproductive, in scoring purchase and sales transactions that take place across the bound-

ary that divides the public and private sectors. It may be that targeted approaches, such as applying a common yardstick to value assets when government sells them to private purchasers, would be effective and also easier for policy makers to adopt than more sweeping changes. Further research into these issues is needed to help craft useful solutions that preserve the integrity of the logic of federal budget and accounting rules and that minimize the risk of unintended consequences.

### **Managing Federal Real Estate and Buildings**

This research would provide an overview of the state of federal real estate and buildings and the quality of management of these assets at federal agencies. The analysis would look at problems of asset management and identify possible solutions to perennial issues such as lack of capacity at many federal agencies to engage in acquisition, exchange, or sale of assets in a market in which the agency may lack experience compared with the private parties who might be on the other side of the table. There also needs to be an evaluation of proposed solutions that sound conceptually attractive but involve practical shortcomings such as resource or organizational constraints.

### **Managing Financial Assets**

This would be a companion piece of research to the work on federal real estate and buildings, described in the preceding paragraph. Financial asset management appears to have evolved to a

more cost-effective state than real property management. This makes it possible to derive lessons from financial asset management that could be usefully applied to real property management. However, the management of financial assets also could be improved, for example, with respect to loan servicing, monitoring of originators and servicers of federal loans, management of defaulted loans and foreclosed property, and loan asset sales.

## **Disposing of Unneeded Federal Assets**

This would be a careful analysis of federal asset disposition, including case studies of promising practices with different types of assets, analysis of the Property Act and proposals for reform of that act, review of the budget issues, and recommendations for reform. For example, is there a way to assist local communities that might be affected by a proposed closure or consolidation of a federal facility? How much money is involved in keeping unneeded facilities open? What can be learned from the Base Realignment and Closure Commission experience?

## **An Agenda for Reform**

Such a study would summarize lessons learned at various federal agencies and propose the application of the most useful lessons on a government-wide basis. The proposed reform agenda would include cost-effective ideas that are assessed for potential attractiveness to policy makers. Improvement of the applicable budget rules and modernization of the Property Act would be two important parts of this research, with careful analysis of the advantages and disadvantages of various reform options.



# Appendix II: Recommendations for Further Reading

## Federal Buildings and Real Estate

National Research Council, *Stewardship of Federal Facilities: A Proactive Strategy for Managing the Nation's Public Assets*, Report of the Committee to Assess Techniques for Developing Maintenance and Repair Budgets for Federal Facilities, Washington, D.C.: National Academy Press, 1998.

U.S. General Accounting Office, *High-Risk Series: Federal Real Property*, GAO-03-122, January 2003.

## Federal Financial Assets

Office of Management and Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2004*, Chapter 9, "Credit and Insurance," 2003, pp. 189–248.

Thomas H. Stanton, "Loans and Loan Guarantees," Chapter 12 in *Tools of Government: A Guide to the New Governance*, Lester M. Salamon, Editor, Oxford University Press, 2002, pp. 381–410.

## Asset Disposition

Small Business Administration, "SBA Loan Asset Sales Program Homepage," <http://www.sba.gov/assets/>.

Thomas H. Stanton, "Lessons Learned: Obtaining Value From Federal Asset Sales," *Public Budgeting & Finance*, Spring 2003, pp. 22–44.

# Endnotes

1. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2004*, pp. 41–42.

2. Information systems are an important kind of personal property. Many government agencies have found large information systems difficult to acquire and absorb. See, e.g., Barry Bozeman, “Government Management of Information Mega-Technology: Lessons from the Internal Revenue Service’s Tax Systems Modernization,” IBM Center for The Business of Government, March 2002.

3. Charles A. Bowsher, “An Emerging Crisis: The Disinvestment of Government,” James E. Webb Lecture, Washington, D.C.: National Academy of Public Administration, December 2, 1988.

4. For example, before September 11 the United States Commission on National Security/21st Century reviewed the inability of key government agencies to cope with likely threats to homeland security and reported that the problem of hollow government was widespread. See, United States Commission on National Security/21st Century, *Road Map for National Security: Imperative for Change*, February 15, 2001, p. xiv.

5. National Research Council, *Stewardship of Federal Facilities: A Proactive Strategy for Managing the Nation’s Public Assets*, Report of the Committee to Assess Techniques for Developing Maintenance and Repair Budgets for Federal Facilities, Washington, D.C.: National Academy Press, 1998, p. 86 (Finding 6).

6. *Ibid.*, p. 65.

7. An interesting case in this regard was DOE’s sale of the Elk Hills oil field in 1997. See, Thomas H. Stanton, “Lessons Learned: Obtaining Value from Federal Asset Sales,” *Public Budgeting & Finance*, Spring 2003, pp. 22–44.

8. Conversely, as the GAO has pointed out, “[a] negative effect, which is not readily apparent but nonetheless

significant, is the effect that deteriorating facilities have on employee recruitment, retention, and productivity. This human capital element is troublesome because the government is often at a disadvantage in its ability to compete in the job market in terms of the salaries agencies are able to offer. Poor physical work environments exacerbate this problem and can have a negative impact on potential employees’ decisions to take federal positions.” U.S. General Accounting Office, *Federal Real Property: Executive and Legislative Actions Needed to Address Long-Standing and Complex Problems*, GAO-03-839T, June 5, 2003.

9. U.S. General Accounting Office, *High-Risk Series: Federal Real Property*, GAO-03-122, January 2003, p. 1. This GAO report provides the basis for many of the statistics and examples cited in this section.

10. *Ibid.*, p. 22.

11. See, e.g., U.S. General Services Administration, Public Buildings Service, *Reinvesting in the American Workplace: A pictorial report on the condition of federal buildings and their repair and alteration needs*, July 2002.

12. *Ibid.*, p. 7.

13. United States Postal Service, *Transformation Plan*, Appendix N—Procedures for Closing Postal Facilities, April 2002; and U.S. General Accounting Office, *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, GAO-02-355, February 2002.

14. The problem of adverse selection is discussed in Thomas H. Stanton, “Credit Scoring and Loan Scoring: Tools for Improved Management of Federal Credit Programs,” IBM Center for The Business of Government, July 1999.

15. As a technical matter, a loan guarantee is a federal contingent liability rather than an asset. However, once a lender makes a claim on a federal loan guarantee, the lender may be allowed to put loans or property, i.e., assets, back to the federal government.

16. For a more complete discussion of stages of the management cycle for loans and loan guarantees, see Thomas H. Stanton, "Loans and Loan Guarantees," Chapter 12 in *Tools of Government: A Guide to the New Governance*, Lester M. Salamon, Editor, Oxford University Press, 2002, pp. 381–409.

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18. Rear Admiral Patrick M. Stillman, "Deepwater: The Integrated Deepwater System Program," presentation to the Standing Panel on Executive Organization and Management of the National Academy of Public Administration, December 13, 2002.

19. U.S. General Accounting Office, *Coast Guard: Comprehensive Blueprint Needed to Balance and Monitor Resource Use and Measure Performance for All Missions*, GAO-03-544T, March 12, 2003.

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21. Ronald Kendall, Public Buildings Service, Office of Portfolio Management, "PBS Portfolio Strategy for Restructuring and Reinvesting in the Owned Inventory," October 5, 2001, p. 3.

22. U.S. General Accounting Office, *Nuclear Cleanup: Progress Made at Rocky Flats, but Closure by 2006 Is Unlikely, and Costs May Increase*, GAO-01-284, February 2001.

23. Descriptive material in this section is taken from Thomas H. Stanton, "Lessons Learned: Obtaining Value from Federal Asset Sales," *Public Budgeting & Finance*, Spring 2003, pp. 22–44, at pp. 31–34.

24. Statement of Thomas Horton, Deputy Director for Asset Disposition, Federal Deposit Insurance Corporation, Federal Credit Institute Workshop on Promising Practices, Financial Management Service, U.S. Department of the Treasury, *Proceedings*, October 3, 1996, p. 176.

25. Information in this section is taken from interviews with Roger Kormendi and Cyrus Gardner, principals of Kormendi-Gardner Partners, Inc., financial advisers and developers of the joint venture structure used in this case.

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to Accelerate Claims Process," press release, November 18, 2002.

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28. See also, Congressional Budget Office, *The Budgetary Treatment of Leases and Public/Private Ventures*, February 2003.

29. See, U.S. General Accounting Office, *Accrual Budgeting: Experiences of Other Nations and Implications for the United States*, GAO/AIMD-00-57, February 2000, at pp. 16–17, 109–110.

30. U.S. General Accounting Office, *General Services Administration: Comparison of Space Acquisition Alternatives—Leasing to Lease-Purchase and Leasing to Construction*, B-281673, March 12, 1999, at pp. 8–9.

31. Marvin Phaup, Congressional Budget Office, "Procedural Safeguards and Federal Asset Sales," working paper, December 20, 1995, p. 2.

32. Statement of Stephen A. Perry, GSA Administrator, before the Subcommittee on Economic Development, Public Buildings, and Emergency Management, Committee on Transportation and Infrastructure, U.S. House of Representatives, April 18, 2002.

33. U.S. General Accounting Office, *High-Risk Series: Federal Real Property*, GAO-03-122, January 2003, p. 39.

34. For an example of the benefits of the government corporation form in managing a financially self-sustaining federal asset, see, National Academy of Public Administration, "Restructuring the Naval Petroleum and Oil Shale Reserves: A Report for the Department of Energy," Washington, D.C., 1994, available from the website of the National Academy of Public Administration Standing Panel on Executive Organization and Management, [www.napawash.org/eom](http://www.napawash.org/eom).

35. U.S. General Accounting Office, *Federal Real Property: Executive and Legislative Actions Needed to Address Long-Standing and Complex Problems*, GAO-03-839T, June 5, 2003, p. 15.

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**Thomas H. Stanton** is a Washington, D.C., attorney. He is a fellow of the Center for the Study of American Government at the Johns Hopkins University, where he teaches graduate seminars on the law of public institutions, government and the American economy, and government and the credit markets. He is the editor (with Benjamin Ginsberg) of a forthcoming book, *Making Government Manageable*, to be published by Johns Hopkins University Press.



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