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BEFORE THE SUBCOMMITTEE
ON TRANSPORTATION AND INFRASTRUCTURE
COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS
UNITED STATES SENATE

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Mr. Chairman and members of the Committee, I am pleased to appear before you today to discuss our review of the Patent and Trademark Office's plan to consolidate its facilities and operations and accommodate its future space requirements.¹ PTO's space consolidation project is expected to be one of the largest real estate ventures that the Department of Commerce, or the federal government, will undertake in the next decade. We have had a long-standing commitment to promoting the efficient management of the Department's facilities. Hence, we share the Committee's interest in ensuring that PTO is housed in facilities that meet its needs in the most cost-effective manner. To this end, we welcome the opportunity to discuss the findings of our review.

¹ *PTO Needs to Refine Its Space Consolidation Planning*, IPE-9724, March 1998. Commerce Department Inspector General reports are available on-line at <http://www.oig.doc.gov/reports/>.

As you are aware, planning for the PTO space consolidation effort began in 1989. In October 1995, this committee approved the prospectus for the project, which calls for the acquisition of a new or rehabilitated facility of up to 2.4 million rentable square feet² located in Northern Virginia. The approved prospectus specified that the facility should have a maximum annual rent of \$57 million for 20 years, for a total of \$1.1 billion, before allowing for inflation. In accordance with that prospectus, and in conjunction with the General Services Administration, PTO plans to award a contract to a private developer to (1) construct a new facility, or renovate an existing facility, and (2) lease it to PTO for a period of at least 20 years. PTO will also have a 10-year lease extension option at year 20 of the lease and purchase options at the 20 and 30-year marks. The solicitation for offers calls for the construction of the building shell and its "build-out" upon completion of the interior design. It is now anticipated that the lease development contract will be awarded in December 1998 or January 1999, with occupancy to begin in November 2001.

When we issued our final report in March 1998, PTO occupied all or parts of 16 buildings in the Crystal City area of Arlington, Virginia, under 32 separate leases yielding 1.7 million occupiable square feet of space, of which approximately 1.4 million is office space.³

² The Congress authorized 2.4 million rentable square feet, which GSA translated to 1.989 million square feet of occupiable space. Rentable space includes areas for which the government will pay rent, but are not useful as office space, such as lobbies, stairwells, rest rooms, and equipment rooms.

³ PTO is in the process of expanding into a 17th and an 18th building and a 33rd lease yielding an estimated total of 1.88 million occupiable square feet. PTO has not yet accepted this additional space because it requires extensive fit-out before it can be occupied.

SCOPE OF OUR REVIEW

Given the size and importance of the proposed PTO consolidation project, our office conducted a review to determine whether (1) the project was justified, and (2) PTO was effectively managing the critical acquisition phase of the project. We examined PTO's acquisition planning and procurement strategies, as well as its current working environment, comprised of 16 current facilities. We also examined PTO's space planning methodology, including the variables used by the agency to generate its space requirements. In addition, we studied the bureau's management of risks associated with the build-out of the building shell. Finally, we examined the respective roles and relationships of the Department, PTO, and the General Services Administration. GSA has a critical role because of its position as the lease development manager of this project. In addition, the Department has an oversight role. Our analysis did not cover the acquisition of new furniture or moving costs for the consolidated facility because that cost information was not available before we issued our report. We also have not analyzed specific Environmental Impact Statements because that process is still ongoing. Our field work lasted from June to December 1997. Our final report was issued in March 1998.

OUR FINDINGS

The results of our inspection were mixed. We found a number of things that PTO was doing well, and we identified areas of concern that warranted the attention of the Department's and PTO's managers. Let me summarize for you our basic findings and recommendations, as outlined in our March 1998 report, and update you as to what actions PTO, and the Department, have taken in response to our report.

The PTO consolidation project should continue. First and foremost, we determined that PTO had justified its need for modern, contiguous office space and that the space consolidation project should continue. PTO's justifications for this project focus on future savings and efficiencies from which the government will benefit. We found that PTO has managed many aspects of the lease development procurement well. The PTO/GSA procurement strategy and the execution of that strategy have generally been successful. PTO has documented the basic requirements and benefits for the new lease development based upon its need for modern, contiguous space that (1) is more efficient and less expensive than its current facilities, and (2) is compliant with the Americans with Disabilities Act and municipal health and safety codes. More specifically:

- Long-term cost savings should be realized because the current leased PTO space is more expensive than the \$24 per square foot target authorized by the approved prospectus and specified in the solicitation.⁴
- Significant growth in the number of patent and trademark applications has increased PTO's workload, and improved facilities should allow PTO to better meet its future staffing and space requirements.
- Current leased facilities in Crystal City, Virginia, are in need of alterations to comply with fire, safety, and handicapped accessibility laws.
- Access for PTO and its customers, both to the facility itself and to public search areas, should be improved with the new consolidated facility.

⁴ The \$24 per square foot number was expressed in 1995 dollars, the year the prospectus was approved by the Congress.

As previously noted, although PTO has generally justified its need for a new facility and has been doing a good job in managing the procurement, our report highlighted a number of concerns and problems that warranted management's attention.

PTO had not finalized its space planning. We found that as of March 1998, PTO had not completed its space planning or issued its space requirements to the offerors with only—at that time—seven months remaining before contract award. Reportedly, PTO had not finalized its space requirements because it had not reached an agreement with its bargaining unit employees over space-related working conditions. In the absence of such an agreement, PTO is not in the best position to prepare its detailed space plans and Program of Requirements for the “build-out” of the new facility. We have been very concerned that the Program of Requirements will not be defined by the scheduled lease award—now anticipated in December 1998 or January 1999. Since the Program of Requirements must be issued upon award of the lease development contract, its delay could cause a major disruption in the award schedule and would likely increase project costs. Likewise, if it is issued on time—but must be changed later—the government could potentially be exposed to change orders that could further delay the project and increase costs.

We also noted in our report that PTO had not fully considered the potential beneficial effects of its information systems reengineering in defining its space requirements. For years, PTO has invested heavily in systems reengineering and automation initiatives. Many of these initiatives were reportedly designed to achieve greater efficiencies and increase productivity by reducing PTO's staff and paper files. This should, in turn, reduce the facilities space requirements. PTO has factored only some of these initiatives, specifically the reduction in paper patent search files, into its planning for the new

facility, based on its assumption that the benefits of reengineering and automation initiatives will not be realized until *after* occupancy of the new facility. We disagreed, suggesting that even partial success and implementation of PTO's reengineering initiatives should result in some benefit and potentially reduce its space requirements.

PTO's build-out strategy exposes the government to cost overruns and program delays. Another of our concerns regarding the PTO consolidation project was that PTO's build-out strategy exposes the government to cost overruns and program delays. PTO's build-out strategy calls for a pool of \$88 million to be set aside for completion or build-out of the basic building shell. The \$88 million build-out allowance will be funded through the lease with the developer. Further, PTO is planning to spend an additional \$29 million for upgraded building systems and interiors. We were critical of the above-standard build-out process because it lacked a defined cost ceiling and is, in some ways, similar to a cost-type, sole-source task order construction project.⁵ Our specific concerns included the following:

- PTO did not have a final budget for the build-out, and there was no ceiling amount specified in the Solicitation for Offers to limit the government's financial exposure.
- The absence of a defined ceiling for the build-out may, in our opinion, act as an incentive for the developers to "buy-in" with low initial offers in the hope of recouping the difference on inevitable change orders to the baseline work.
- Without build-out specifications, the offerors are subject to performance risk, which may be incorporated into their offers as cost contingencies, increasing the cost to the government.

⁵ A cost-type, sole-source task order construction contract can create a situation where the contractor has little incentive to control costs.

- The lack of build-out specifications increases the likelihood of change orders to correct incomplete specifications or correct deficient ones.

The respective roles and responsibilities of PTO and GSA had not been defined in a memorandum of understanding. A third area of concern was that PTO and GSA had not completed a memorandum of understanding outlining their respective roles. Further, the fee structure between the agencies had not been defined. At the time of our report, discussions between PTO and GSA for GSA's build-out management fee included the possibility of a cost-based fee of between three and nine percent of incurred costs. We identified two problems with this possibility:

- The budgetary ceiling for the build-out had not been defined and GSA was expecting to receive a percentage of the costs expended. This equates to a cost-plus-percentage-of-cost fee arrangement—a practice that would be prohibited in federal contracts. Although such an arrangement is not clearly prohibited in conjunction with interagency agreements, we are nonetheless concerned that it may act as a disincentive to use sound management practices and thus drive up costs.
- In the event GSA received any fee above six percent, it would be receiving a fee in excess of the statutory ceiling for a federal cost-type construction or architect-engineering contract. While not prohibited *per se* in interagency agreements, a fee of such magnitude would appear to be excessive.

In addition, we found that the two agencies had not determined whether, or under what terms, PTO might subsequently turn back unneeded space to GSA. As the primary lease holder for the federal government, GSA has traditionally had a generous policy of accepting unneeded space from its agency customers. Hence, PTO's right to turn back unneeded office space is a critical element in PTO's facilities management strategy. Given the possibility that systems reengineering could eventually reduce PTO's space requirements, PTO wants to have the future option of relinquishing unneeded space to

GSA. However, GSA's policy of accepting such office space is potentially strained by the sheer magnitude of this lease development, the expiration of the Federal Property Management Regulations, and evolving GSA policies regarding the acceptance of relinquished leased property.

Lastly, we were concerned that GSA's continuing role as construction manager had not been defined. This was important since (1) the Public Buildings Act specifies that only GSA may construct or manage the construction of buildings designated for federal government use, and (2) GSA is the federal government expert in construction and construction management. We felt that GSA should have a continuing role in the completion of the new PTO project.

The Department of Commerce needed to improve its real estate management oversight of the PTO project. In our March report, we also emphasized that the Department needed to improve its real estate management oversight of the PTO consolidation project. We noted that the Department's real estate staff had not adequately monitored the progress of the PTO lease development project, one of the largest federal construction or lease projects in the Washington metropolitan area. As a result, the real estate staff did not foresee PTO's late start and slow progress in its union discussions.

OUR RECOMMENDATIONS

In our March 1998 report and in subsequent discussions with senior PTO and Commerce managers, we made specific recommendations aimed at improving the PTO space consolidation project. Specifically, we recommended that:

- PTO and the Department continue with the lease development project.
- PTO finalize its space requirements to include—hopefully—an agreement with its employee unions, giving added consideration to the potential systems reengineering savings in its space model, and completing its Program of Requirements.
- PTO conclude a memorandum of understanding with GSA detailing the rights and responsibilities of each agency and defining GSA's fee arrangement. Further, the GSA fee should not be based on a percentage of costs expended, an arrangement that could act as a disincentive for sound management practices.
- The Department's real estate management staff should take a greater role in planning and oversight of the consolidation project.

THE RESPONSE TO OUR REVIEW AND WHAT'S HAPPENED SINCE

PTO, the Department, and GSA all responded to our report and agreed to most of our recommendations. Not surprisingly, they agreed that the project should proceed. There were, however, some areas of strong disagreement. For instance, PTO did not agree that a contractual ceiling for the build-out was necessary to reduce the risk of cost growth. PTO suggested that the annual budget process would ensure that government resources were not wasted.

However, PTO did take various steps to address specific concerns. For example, as a result of our review, PTO accelerated its space planning efforts and issued draft space planning documents.⁶ Based upon our analysis of these draft plans, we were able to

⁶ PTO prepared its draft Space Allocation Plan on October 1, 1997, and released it in response to our draft report dated December 23, 1997.

determine that PTO had justified its need for 1,989,116 occupiable square feet for its consolidated facility. In addition, these draft plans—if necessary—can be quickly finalized for use as the Program of Requirements to guide the consolidation project build-out.

It is our understanding that PTO's space planning has not been completed because the bureau has not reached an agreement with all of its employee unions over space-related working conditions. PTO management has informed us that if they have not executed such agreements with the employee unions by the time the lease is awarded, they plan to proceed with the draft space plans and incorporate them as the final Program of Requirements. Clearly, this is not ideal and increases the risk of schedule delays and the possibility of higher costs. For example, a lengthy delay may cause one or more of the offerors to drop out of the competition due to a loss in financing or other development plans for their sites.

In response to our review, PTO stated that it had accounted for the space savings associated with the “universal grid concept”⁷ and some portions of reengineering, such as the elimination of paper search files for patent examination. Further, PTO argues that the most important reengineering initiative, electronic patent filing, will not be available until five years after occupancy of the new facility. PTO has stated that the ability to relinquish unneeded space back to GSA reduces the risk that PTO may lease too much space, if reengineering does, in fact, reduce the bureau's space requirements. We continue to believe that PTO can eventually reap additional space savings through the

⁷ The universal grid concept is a space planning and functional work plan that allocates the same size offices to all employees. In this case, PTO anticipates allocating 120-square-foot offices to virtually all PTO employees, including most managers.

reengineering of its patent and trademark processes. PTO managers should continue to pursue such initiatives and actively work to implement them as soon as possible.

PTO and GSA have executed a memorandum of understanding, as we recommended. On September 4, 1998, PTO and GSA concluded a memorandum of understanding that reportedly addresses our concerns regarding GSA's fees, PTO's right to turn back unneeded space, and GSA's role as the construction manager. Although we have not yet had an opportunity to examine the fee structure in detail, the memorandum of understanding appears to allocate risk between PTO and GSA and define the rights and responsibilities of each agency.

It should be noted that there has also been some progress in mitigating PTO's build-out risk. Our concern that PTO did not have a firm ceiling on its \$29 million build-out has been addressed by the Congress, PTO, and GSA. With legislation pending in both the Senate and the House, there seems to be growing Congressional support for a ceiling on PTO's build-out. Pending legislation would place a \$29 million ceiling on PTO's "above standard" build-out costs. In addition, PTO and GSA have agreed to manage the build-out effort to a \$29 million ceiling. As an added safeguard, we would like to see a \$29 million build-out ceiling also expressed in the contract award itself.

In response to our recommendation that the Department provide oversight, assistance, and guidance to the PTO space project, the Department has clearly established and is maintaining a higher level of involvement in the project. The Department has, for example, assigned both real property and procurement personnel to coordinate ongoing planning activities and assist in the source selection process. Moreover, the Department

has contracted with procurement and commercial real estate consultants and other experts to examine other aspects of the PTO project.

In closing, we believe that PTO needs to continue to move forward with its competitive space consolidation project. We believe greater risk lies in delaying the project. PTO has made progress in its discussions with its unions, and we encourage them to press on. We believe that it is in the interest of the Department and the inventing public to proceed with this lease development while at the same time paying close attention to containing costs as the project continues.

This concludes my statement, Mr. Chairman. I would be pleased to answer any questions you or the other Members of the Committee may have.