



March 1, 2011

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SUBJECT: Audit Report – Facility Optimization: Southwest Area
(Report Number DA-AR-11-003)

This report presents the results of our audit of facility optimization in the Southwest Area (Project Number 10YG028DA000). The U.S. Postal Service Office of Inspector General (OIG) initiated this audit from a random sample of districts nationwide. For the Southwest Area, our objective was to identify opportunities to optimize existing real estate in the Houston and Oklahoma Districts. See [Appendix A](#) for additional information about this audit.

The two districts analyzed in the Southwest Area uses over 885 facilities covering nearly 7 million square feet (SF) of interior space for its delivery and retail operations. While the area employs these facilities, it has experienced a significant reduction in workload in recent years. From fiscal years (FYs) 2005 to 2010, mail volume in the Southwest Area has dropped more than 18 percent. Likewise, mail volume in the Houston District has decreased by approximately 15 percent and in the Oklahoma District by approximately 14 percent. This reduction in workload provides an opportunity to reevaluate space needs and identify potential excess space.

Conclusion

In the Southwest Area, the Houston and Oklahoma districts have over 2.3 million SF in excess of what their workload suggests they need. The U.S. Postal Service has the option to optimize excess real property through:

- Disposal – selling property.
- Outleasing – leasing owned property.
- Subleasing/Reassignment – reassigning leased property.
- Development – investing in real estate projects.

With a major effort underway, the Postal Service has begun taking action to optimize existing space. Specifically in the Houston and Oklahoma Districts, the Southwest Area plans to dispose of 66,322 SF of this excess space through approved optimization projects. Although it has made progress, the Postal Service can do more to dispose of excess interior space more quickly.

The opportunity to optimize excess interior space in the reviewed districts exists because:

- Postal Service policy requires installation heads to report excess space, but does not provide the necessary guidance to effectively accomplish this task.
- The excess space reporting system does not track metrics such as dates or space conditions to allow for prioritizing disposal actions.

We estimate that if the Southwest Area initiates disposal¹ action for the excess space we identified in the Houston and Oklahoma Districts, there is an opportunity to realize \$99,618,007² over typical and remaining lease terms. We consider this amount to be funds put to better use.³ See [Appendix B](#) for our detailed analysis of this topic and [Appendix C](#) for our calculation of monetary impact.

Our audit also noted that the Postal Service could be more aggressive in seeking opportunities to fill the space needs of federal entities. In the districts reviewed, our analysis shows that excess space identified at Postal Service facilities may be able to accommodate 85 percent of current federal agencies' space needs. This opportunity exists because the Postal Service has not capitalized on the priority status it has for filling federal agencies' space needs. By capitalizing on this status, the Postal Service has another option for reducing its facility infrastructure size and generating additional revenue. See [Appendix D](#) for more information.

We recommend the vice president, Operations, Southwest Area; district managers; area managers; and the Southwest Facility Service Office manager work in coordination to:

1. Clarify procedures for reporting excess space.
2. Initiate disposal actions for excess space identified.
3. Pursue opportunities with federal agencies as an option to optimize excess property.

¹ Disposal actions available include sale, termination of lease, consolidation, and/or subleasing. At a minimum, the Postal Service can out-lease or initiate a sublet action for owned or leased property, respectively.

² The annualized savings is \$9,961,801.

³ Funds that could be used more efficiently by implementing recommended actions. This amount does not include excess square footage that is part of an approved node study.

Management's Comments

Management agreed with the finding that excess space exists in a number of facilities, agreed to the first two recommendations made, and stated they will have corrective actions to address them in place by March 2011. Management in a separate email conveyed agreement with the third recommendation and will also complete this action by March 2011. While management agreed to develop a more accurate process and additional metrics to better manage excess space, they did not agree with the amount of excess space or the potential monetary impact reported. Specifically, they disagreed with the methodology used to calculate existing excess space, in addition to the data and cost factors used to value the excess space and calculate monetary impact.

In reference to the level of excess space reported, management conveyed that our methodology does not include allowances for:

1. Unusable space such as basements and corridors (they provided a picture of a basement mechanical room to exemplify the point).
2. Unique operational functions not included in standard designs and inefficiencies in the current building layouts.
3. Historic property.
4. Parking and dock space requirements.
5. Large inflexible retail lobbies.

In reference to the data and cost factors used in our calculations, management disagreed with the:

- Building inventory and interior space results.
- Number of approved optimization studies reported.
- Commercial value of excess space.
- Average vacancy rate and absorption period for sublease space.
- Amount of finish allowance to restore excess space.
- Sublease efficiency rate used to calculate the amount of excess space that could potentially be successfully subleased.
- Build-out cost factors.

In addition, management believes the accurate way to calculate monetary impact is by multiplying useable excess space by sublease value less conversion cost. This calculated outcome should then be adjusted for maintenance and utility savings.

Finally, management expressed the challenges facing the Postal Service when disposing of property in poor market conditions and actions they have already taken to reduce excess property. In particular, management has focused its attention on properties that have more than 10,000 interior SF. This represents 16 percent of all buildings and 76 percent of total interior square footage. This allows the Postal Service to capture the largest opportunities for excess space that is usable. See [Appendix E](#) for management's comments in their entirety.

Evaluation of Management's Comments

Considering the rapid decline of workload and the dynamic nature of excess space, the OIG considers management's comments responsive to the recommendations. Management's corrective actions over time should resolve the issues identified in the report. With respect to the methodology used to calculate excess space, we did not determine whether the excess space identified was usable, in part because Postal Service systems do not identify usable areas. We agree that realty management policies and systems need to be updated to define usable areas. According to commercial realty standards,⁴ usable areas are generally measured from "paint to paint" inside the permanent walls to the middle of partitions. No deductions are made for columns and projections necessary to the building. Our calculations reflect these standards.

As it relates to the usability of basements, we note that Postal Service Headquarters and many federal agency buildings use basement space. According to commercial realty standards, basement space is counted as usable and leasable areas. Mechanical rooms are considered common areas which a proportionate share is allocated to a tenant's area. We did not include allowances for existing functions, building layout inefficiencies, and inflexible spaces because the Postal Service's current space standards did not specify these allowances. Our audit focused on interior excess space, thus, enclosed parking and dock spaces were outside the scope of the audit.

Management also conveyed that we did not consider the historic nature of buildings and the challenges or costs associated with making changes to these buildings. While we agree that there are properties of the Postal Service that are historic in nature, we do not feel this has a large impact in the presentation of our results. The number of eligible historic buildings listed in the Postal Service's systems account for less than 1 percent of their properties. Also, while the Postal Service is required to consult with historical organizations, they are not bound by these consultations or decisions.

The standard building design matrix served as the basis for determining earned space. During the on-site visits, we inquired whether there were unique operations conducted

⁴ www.boma.org.

at the facility and whether they were allotted the necessary space for those functions. Conservatively, we did not consider performance measures such as street efficiency or alternate access sales channels which would decrease the earned facility size and increase excess space. We did not apply the standard building design criteria to plants or administrative facilities. Administrative facilities were not in the scope of our review. In those instances where administrative space was co-located with operational space, we specifically excluded the administrative space from our calculations.

The Postal Service does not have a methodology of determining “build-out” costs at a national, area or district level. As such, to determine build-out costs we used the average build-out costs for the district as presented in their node studies. We note that build-out costs are negotiable and lessees, at times, absorb the cost of conversion. We built in several different tolerances relating to the size of excess space at sites reviewed and considered the marketability of properties within the districts. Further, the multiple actions, such as lease terminations, disposals, and space/lease reductions within the approved node studies were acknowledged and reflected in our monetary impact calculations.

We recognized realty market conditions and discounted our excess space calculations by the national commercial vacancy rate of 13.3 percent. A review of Houston and Oklahoma City realty prices indicated that the average commercial value we used in our calculations (\$7.34) is within a 10 to 50 percent discount rate range offered for space quality and market conditions and is below the average General Services Administration (GSA) lease rates. In reference to absorption costs, management incurs these costs at lease initiation and is not relevant to the cash flow analysis. Therefore, using the Postal Service’s cash flow method and cost of borrowing, we consider our presentation of the level of excess space and value a reasonable estimate of the opportunity loss associated with unproductive assets.

Finally, we recognize the efforts made to optimize Postal Service real estate and management’s attention to properties greater than 10,000 SF. We believe that once management modernizes its realty management systems to have greater visibility of excess space, it will be able to better prioritize disposal actions associated with its full building inventory and place itself in a better position to take advantage of its priority status with the GSA.

The OIG considers all the recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Miguel A. Castillo, director, Engineering and Facilities, or me at 703-248-2100.

E-Signed by Mark Duda 
VERIFY authenticity with ApproveIt


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Attachments

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APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The Southwest Area leases or owns over 885 facilities in the Oklahoma and Houston Districts, covering nearly 7 million SF of interior space, for delivery and/or retail operations to move the mail. The consolidation or closure of facilities is a widely discussed topic due to declining mail volume and the resulting financial condition of the Postal Service. In response, the Postal Service's Facilities and Retail Management organizations have implemented initiatives to optimize space, namely, initiation of the Facility Optimization Program and the Station and Branch Optimization Consolidation (SBOC) program.

In April 2008, the vice president of Facilities initiated the Facility Optimization Program to balance the portfolio of existing delivery facilities with the Postal Service's current and projected space needs. The program's objectives are to generate revenue and reduce rent obligations and operational costs. The process entails identifying, investigating, analyzing, and approving space before executing the approved optimization action. The Southwest Area has three approved optimization studies in the Oklahoma District and five in the Houston District.

Established in May 2009, the SBOC program provides tools and strategies to evaluate the effectiveness of Postal Service retail placement in support of the *Transformation Plan's* goals of improved service and increased revenue.

In addition to the ongoing optimization studies and SBOC program, the districts have taken the following initiatives to consolidate space:

- The Southwest Area Districts have initiated reviews of delivery optimizations. For example, at the time of our review, the Rio District had initiated Delivery Unit Optimization projects.
- There are seven Area Mail Processing (AMP) studies currently in process to optimize space at processing plants and there are two additional AMP studies planned for FY 2011.
- There is an AMP study awaiting approval for consolidating the Houston GPO, the Houston DDC, and the Houston District office into the North Houston Processing & Distribution Center.

In October 2010, the Postal Service consolidated optimization efforts to manage excess space. The goal is to manage the excess space portfolio for all space types in one overall optimization effort.

Currently, the Postal Service has a program in place to optimize carrier delivery facilities through the use of node studies⁵. However, the Postal Service will now include mail processing plants, retail facilities, small delivery units, administrative space, and carrier delivery facilities in one overall optimization effort. The goal is to manage the excess space portfolio for all space types in one overall initiative. This integrated effort between Facilities Headquarters and the field offices will use computer modeling and equipment analysis along with local analysis and metro planning to form a headquarters and district/area partnership.

To supplement and expand on existing Postal Service initiatives, the OIG developed a Real Estate Risk Model (RERM) to identify and prioritize emerging facility risk. The risk model measures facility performance results by district for the following nine metrics:

Table 1 – Risk Metrics

RERM Metrics	
Ratio of Mail Volume to Interior SF	Excess USPS Identified Interior Space
Ratio Revenue to Interior SF	Excess Land
Ratio of Total Expense to Interior SF	Facility Condition
Ratio of Employees to Interior SF	Density, Geographic Location
Ratio of Retail Revenue to Total Expense	

We randomly selected 17 districts to study excess interior space on a national basis; two districts selected are in the Southwest Area.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to identify opportunities for the Postal Service’s Southwest Area to optimize existing real estate. We visited 65 of 885 facilities⁶ in the Oklahoma and Houston Districts, representing 49.5 percent of the OIG-calculated excess space when actual interior space is compared to space standards. The scope of the audit primarily included main post offices, carrier annexes, stations, branches, and mail processing facilities. To accomplish our objective we visited selected facilities, conducted interviews, and examined other relevant materials.

To calculate an earned⁷ facility size, we compared the workload data from Postal Service databases⁸ to the number of carrier routes, the number of rented post office box sections, and peak window use. We based the earned facility size on Postal Service criteria⁹ for

⁵ Studies of consolidation for sites in a geographic radius.

⁶ We excluded administrative facilities from our review.

⁷ We used Postal Service criteria established in March of 2007 outlined in a letter issued by the senior vice president of Operations. In support of this newly established criteria, the Headquarters Facility Group, Planning and Approval, designed Space Requirements Models (SRMs) to assist with the space requirements of planned facilities. We did not test the reasonableness of the SRMs.

⁸ Web Box Activity Tracking System (WebBATS) Monthly Summary Data for issued Post Office Box information, Intelligent Mail and Address Quality (IMAQ) Delivery Statistics Summary for route information, and Retail Data Mart for earned peak modeled window staffing.

⁹ Space Requirements Matrix for Non-Flat Sequencing System (FSS) offices.

planning new space projects, which differs from existing Postal Service initiatives¹⁰ because it focuses on the total facility size, not specific retail or delivery operations. We calculated excess space by taking the difference between earned facility size and actual interior SF reported in the electronic Facilities Management System (eFMS). For the plants, area operations management provided us the excess space data which we assessed for reasonableness.

We conducted this performance audit from June 2010 to March 2011 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We discussed our observations and conclusions with management officials on January 5, 2011, and included their comments where appropriate.

We assessed the reliability of facility-related data by verifying the accuracy of computer generated information through observations during facility tours and interviewing agency officials knowledgeable about the data. We determined that the data was sufficiently reliable for the purposes of this report.

PRIOR AUDIT COVERAGE

The following audit reports are relevant to Postal Service’s facility infrastructure.

Report Title	Report Number	Final Report Date	Monetary Impact	Report Results
<i>Facility Optimization: Northern New Jersey District</i>	DA-AR-10-008	8/25/2010	\$157,963,990	The OIG identified 1.98 million SF of excess space. The Postal Service agreed with the recommendations but disagreed with the monetary impact.
<i>Facility Optimization: Chicago District</i>	DA-AR-10-009	8/25/ 2010	\$23,517,019	The OIG identified 740,000 SF of excess space. The Postal Service agreed with the recommendations but disagreed with the monetary impact.
<i>Facility Optimization : New York District</i>	DA-AR-10-010	8/25/2010	\$446,258,222	The OIG identified 2.4 million SF of excess space. The Postal Service agreed with the recommendations but disagreed with the monetary impact.

¹⁰ SBOC and Facilities Optimization Program.

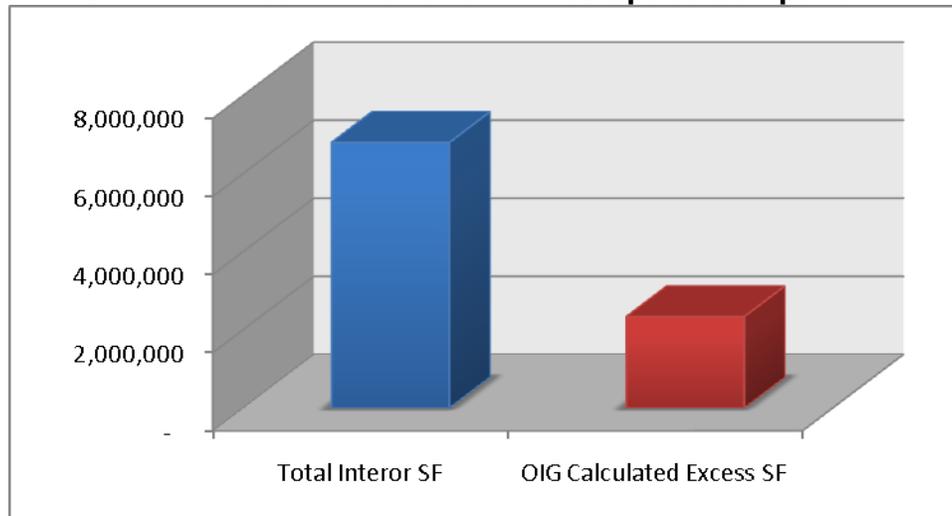
Report Title	Report Number	Final Report Date	Monetary Impact	Report Results
<i>Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability</i>	GAO-09-937SP	7/28/2009	None	The Government Accountability Office added the U.S. Postal Service's financial condition to the list of high-risk areas needing Congress' attention and the executive branch to achieve broad-based transformation. It recognized the need to reduce the facility infrastructure. There was no Postal Service response in the report.
<i>Federal Real Property: An Update on High Risk Issues</i>	GAO-09-801T	7/15/2009	None	Federal agencies have taken some positive steps to address real property issues but some of the core problems that led to designation of this area as high-risk continue to persist. There was no Postal Service response in the report.
<i>Network Rightsizing Needed to Help Keep USPS Financially Viable</i>	GAO-09-674T	5/20/2009	None	The Postal Service will require action in a number of areas, such as rightsizing its retail and mail processing networks by consolidating operations and closing unnecessary facilities. The Postal Service generally agreed with the accuracy of the statements and provided technical comments, which were incorporated.

APPENDIX B: DETAILED ANALYSIS

Excess Space is Significant in the Southwest Area

Based on facility space requirements,¹¹ we calculated that the districts reviewed in the Southwest Area maintain 2.3 million SF more than what is required for current operational workload, thus can be considered potential excess space. As depicted in Chart 1, excess space was at least 34 percent of the total interior square footage.

Chart 1 – Area Interior and Excess Space Comparison



The breakdown of interior square footage and OIG-calculated excess space for the 65 visited facilities in the Southwest Area is represented in Table 2. Main post offices and stations contributed 29 percent and 28 percent of the excess space, respectively, while plants (18 percent) and carrier annexes (10 percent) followed to a lesser degree.

Table 2 – Excess Space by Facility Type Visited

Facility Type	Facility Type Count	Percentage of Count	Percentage of Excess	OIG-Calculated Excess SF	Interior Square Footage
Main Post Office	6	10.2%	28.9%	259,185	490,535
Station	30	50.8%	28.2%	252,781	605,081
Carrier Annex	11	18.6%	11.3%	101,101	193,423
Branch	2	3.4%	2.2%	19,826	42,326
Plant	3	5.1%	21.8%	195,304	458,039
Finance Station	7	11.9%	7.6%	67,746	94,746
Total	59¹²	100%	100%	895,943	1,884,150

¹¹ We used Postal Service criteria established in March of 2007 outlined in a letter issued by the senior vice president of Operations. In support of this new criteria, the Headquarters Facility Group, Planning and Approval, designed matrices to assist with the space requirements of planned facilities.

¹² Although we visited 65 sites, this table only includes sites at which we identified excess space. We identified no excess space at six sites.

To highlight excess space in the Southwest Area, Illustration 1 depicts two facilities with excess interior space. The Sam Houston Carrier Annex is a Postal Service-owned facility containing only delivery operations. The Tulsa MPO is a large Postal Service-owned facility that previously functioned as the Tulsa Processing and Distribution Center, but currently contains only delivery and retail operations. According to our calculations, 91 percent of the sites visited contained excess space, ranging from 310 SF to 213,636 SF.

Illustration 1 – Examples of Excess Space

<p>Sam Houston Carrier Annex 1500 Hadley Street Houston, Texas Interior Square Footage: 25,206 OIG-Calculated Excess SF: 18,706</p>  <p>01/01/2010 AM 03:22</p>	<p>Tulsa Main Post Office 333 W 4th Street Tulsa, Oklahoma Interior Square Footage: 392,586 OIG-Calculated Excess SF: 213,636</p>  <p>08/11/2010 PM 05:50</p>
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Causes for Excess Interior Space

The opportunity to optimize excess interior space in the Southwest Area exists because:

- Postal Service policy requires installation heads to report excess space, but does not provide the necessary guidance to effectively accomplish this task.
- Facility systems do not track metrics such as dates or space conditions to allow effective management of excess space.

[Guidance Can Be Improved](#)

A review of the facility database user guide shows it does not provide sufficient guidance for identifying excess space using the workload-driven space requirements.

For example, the facility database space survey asks installation heads to objectively answer *“Do you have any vacant space in your facility that is in leasable condition and has access that does not compromise the security of the operation?”* without providing further guidance or referencing space standards. While we identified excess space at 59 of the 65 Postal Service facilities we visited, only one location answered “yes” to our survey question concerning vacant leasable space. Further, our interviews revealed Operations’ employees were unaware of the methodology used to identify excess space at their facilities. As a result, we identified over 2.3 million SF of excess space in the Oklahoma and Houston Districts.

Facility Systems Do Not Allow for Effective Management of Excess Space

The Postal Service is experiencing a considerable workload decline which has resulted in significant excess space. However, the electronic system that manages facility space does not collect or monitor metrics such as length of time space is underused or vacant and the condition of excess space in order to efficiently prioritize disposal actions.

For comparison purposes, we benchmarked Postal Service facility practices against the GSA realty management practices and found that GSA “ages” its available space for tracking, monitoring, and decision-making. The Postal Service does not have the ability to age excess space as it does not collect dates on entry.

GSA’s Public Buildings Service also manages its leased portfolio by focusing on four primary areas: reducing vacancy, managing lease administration expenses, managing customer requirements, and analyzing market trends. Similarly, GSA-owned facilities are monitored and analyzed using performance metrics such as revenue, funds from operations, operating costs, vacancy, net operating income, and return on equity. The Postal Service’s facility management systems are not able to manage property in this manner. For example, rents from leases or subleases are tracked manually using electronic spreadsheets.

Additionally, because the Postal Service’s eFMS calculates space based on delivery and retail metrics, the excess space reported for processing and distribution plants is inaccurate. Therefore, it is not a reliable source for identifying how much excess space is available in its plants. The Postal Service plans to measure plants and update the facility database.

We estimate if the Southwest Area initiated disposal actions for the districts reviewed, there is a potential opportunity to realize \$99,618,007¹³ over typical and remaining lease terms. This amount is considered funds that could be used more efficiently by implementing recommended actions. See [Appendix C](#) for the monetary impact calculation and assumptions.

¹³ The annualized savings is \$9,961,801.

Opportunity to Fulfill Federal Space Needs

GSA is the nation's largest public real estate organization. It provides workspace for more than one million federal workers through its Public Buildings Service. According to the Code of Federal Regulations (CFR), in situations when GSA-controlled space is not available, federal agencies must extend priority consideration to available space in Postal Service buildings.¹⁴

Our audit noted that the Postal Service can be more aggressive in seeking opportunities to fill the space needs of federal entities. Table 3 illustrates the potential fulfillment opportunities in the two Southwest Area Districts we reviewed. Specifically, it shows that GSA leases on behalf of federal entities primarily from the commercial sector rather than the Postal Service. Space requirements were greater than the excess space identified in Postal Service facilities. GSA paid considerably more per square foot than the value assigned to the Postal Service space.¹⁵

Table 3 – Postal Service Excess Space Lease Opportunity

Districts	GSA Leased SF	OIG Excess SF	GSA Facility Count	Postal Service Facility Count	Existing GSA/ USPS Leases	GSA Average SF Cost	OIG Average SF Value	Number of GSA Leases Excess Space may Accommodate
Oklahoma	1,487,696	1,322,853	115	370	6	\$17.57	\$7.34	106 of 115 92%
Houston	1,688,040	1,039,475	111	203	9	\$23.27	\$8.51	85 of 111 77%
Totals	3,175,736	2,362,328	226	573	15	\$14.94	\$7.85	191 of 226 85%

Table 3 and [Appendix D](#) also illustrate the strong correlation between space leased by the GSA and the ability of the Postal Service to significantly accommodate federal space needs. For the two districts reviewed, we estimate that Postal Service excess space may accommodate 191 of 226 (or 85 percent) of current federal leases. However, we understand that more information is necessary before determining whether the Postal Service’s excess space would be suitable.

¹⁴ 41 CFR 102-73.25.

¹⁵ We assigned Postal Service excess space a value based on historical lease rates in the same geographic areas.

APPENDIX C: MONETARY IMPACTS

Funds Put To Better Use

<i>Houston Excess Interior Space Monetary Impacts</i>										
Project year	0	1	2	3	4	5	6	7	8	9
Fiscal year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<u>Owned</u>										
Sublease Value	(\$13,521,881)	\$7,435,231	\$7,435,231	\$7,435,231	\$7,435,231	\$7,435,231	\$7,435,231	\$7,435,231	\$7,435,231	\$1,858,808
Utility Savings		\$1,852,604	\$1,895,214	\$1,938,804	\$1,983,396	\$2,029,014	\$2,075,682	\$2,123,422	\$543,065	
Custodial Savings		\$2,009,193	\$2,009,193	\$2,009,193	\$2,009,193	\$2,009,193	\$2,009,193	\$2,009,193	\$502,298	
<u>Leases Expiring FY 2011</u>										
Sublease Value	(\$495,880)	\$272,668	\$272,668	\$272,668	\$272,668	\$272,668				
Utility Savings		\$67,939	\$69,502	\$71,101	\$72,736	\$74,409				
Custodial Savings		\$73,682	\$73,682	\$73,682	\$73,682	\$73,682				
<u>Leases Expiring After 10/1/2011</u>										
Sublease Value	(\$1,734,450)	\$953,716	\$767,296	\$642,529	\$560,451	\$501,701	\$463,624	\$340,175	\$299,911	\$188,862
Utility Savings		\$237,633	\$195,581	\$167,545	\$149,504	\$136,910	\$129,429	\$97,150	\$87,621	\$56,447
Custodial Savings		\$257,719	\$207,343	\$173,628	\$151,448	\$135,573	\$125,283	\$91,924	\$81,044	\$51,036
Subtotal	(\$15,752,211)	\$13,160,385	\$12,925,710	\$12,784,379	\$12,708,309	\$12,668,380	\$12,238,441	\$12,097,096	\$3,372,747	\$296,345
Cash Flows @ Sub Lease Efficiency Rate	(\$13,657,167)	\$11,410,054	\$11,206,591	\$11,084,057	\$11,018,104	\$10,983,486	\$10,610,729	\$10,488,182	\$2,924,172	\$256,931
Discounted at Postal Service cost of borrowing	(\$13,657,166.7)	\$10,984,408.1	\$10,386,074.6	\$9,889,302.0	\$9,463,737.9	\$9,082,073.4	\$8,446,542.8	\$8,037,536.5	\$2,157,320.0	\$182,480.6
Net Present Value: \$54,972,309										

Build-Out Costs SF	\$30.84	Utilities Savings SF per Year	\$2.12
Lease Savings SF per Year	\$8.51	Utility Cost Escalation Rate	2.30%
Postal Service Cost of Borrowing	3.875%	Custodial Rate SF	\$2.30

<i>Oklahoma Excess Interior Space Monetary Impacts</i>										
Project year	0	1	2	3	4	5	6	7	8	9
Fiscal year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Owned										
Sublease Value	(\$15,981,798)	\$7,577,263	\$7,577,263	\$7,577,263	\$7,577,263	\$7,577,263	\$7,577,263	\$7,577,263	\$1,894,316	
Utility Savings		\$1,330,875	\$1,361,485	\$1,392,799	\$1,424,833	\$1,457,605	\$1,491,129	\$1,525,425	\$390,128	
Custodial Savings		\$1,043,746	\$1,043,746	\$1,043,746	\$1,043,746	\$1,043,746	\$1,043,746	\$1,043,746	\$260,936	
Leases Expiring FY 2011										
Sublease Value	(\$1,102,349)	\$522,644	\$522,644	\$522,644	\$522,644	\$522,644				
Utility Savings		\$91,797	\$93,909	\$96,069	\$98,278	\$100,539				
Custodial Savings		\$71,993	\$71,993	\$71,993	\$71,993	\$71,993				
Leases Expiring After 10/1/2011										
Sublease Value	(\$3,336,889)	\$1,582,080	\$1,119,170	\$771,076	\$531,076	\$367,431	\$325,008	\$282,878	\$251,419	\$238,393
Utility Savings		\$277,877	\$201,093	\$141,734	\$99,864	\$70,681	\$63,958	\$56,948	\$51,779	\$50,225
Custodial Savings		\$217,927	\$154,162	\$106,213	\$73,154	\$50,613	\$44,769	\$38,966	\$34,632	\$32,838
Subtotal	(\$20,421,037)	\$12,716,202	\$12,145,464	\$11,723,536	\$11,442,850	\$11,262,513	\$10,545,873	\$10,525,226	\$2,883,210	\$321,457
Cash Flows @ Sub Lease Efficiency Rate	(\$17,705,039)	\$11,024,947	\$10,530,118	\$10,164,306	\$9,920,951	\$9,764,598	\$9,143,272	\$9,125,371	\$2,499,743	\$278,703
Discounted at Postal Service cost of borrowing	(\$17,705,038.8)	\$10,613,667.5	\$9,759,131.1	\$9,068,691.3	\$8,521,365.1	\$8,074,194.4	\$7,278,391.4	\$6,993,156.7	\$1,844,195.8	\$197,944.0

Net Present Value: \$44,645,698			
Build-Out Costs SF	\$19.76	Utilities Savings SF per Year	\$1.29
Lease Savings SF per Year	\$7.34	Utility Cost Escalation Rate	2.30%
Postal Service Cost of Borrowing	3.875%	Custodial Rate SF	\$1.01

Value Assigned to the Excess Space

Table 4 shows the value per square foot for both districts. Using the Facility Inventory Reports from the eFMS, we calculated this figure by dividing total interior square footage by the total lease costs.

Utility Costs Associated with the Excess Space

Table 4 shows the utility cost per square foot for both districts. Using the information from line 42 in the Financial Performance Report (FPR), we calculated this figure by dividing the total annual utility expenses by the district’s total interior square footage, with a cost escalation rate of 2.3 percent.

Maintenance Costs Associated with the Excess Space

Table 4 shows the maintenance cost per square foot for both districts. We calculated this cost by dividing the total annual maintenance expenses¹⁶ by the district’s total interior square footage. However, we reduced the cost by 50 percent, based on savings previously identified in a prior custodial maintenance audit.¹⁷

Build-Out Costs Associated with Implementing Optimization Actions

Table 4 shows the build-out cost per square foot for both districts. These figures reflect the average build-out cost per square foot for the Southwest Area, calculated at \$15.48¹⁸. We calculated the area build-out cost per square foot by dividing the “build-out/Line 63 capital” costs for all approved optimization node studies in the Southwest Area by the total reduction in square footage identified in the approved node studies.

Table 4 – Square Footage Costs by District

District	Lease Cost/SF	Utility Cost/SF	Maintenance Cost/SF	Build out Cost/SF ¹⁹
Houston	\$8.51	\$2.12	\$2.30	\$15.48
Oklahoma	\$7.34	\$1.29	\$1.01	\$15.48

¹⁶ eFlash (Labor Distribution Code 38, salary and benefits) + FPR Line 3F Contract Cleaners Costs

¹⁷ Custodial Maintenance Audit Report, (Report Number DA-AR-09-011, dated August 13, 2009).

¹⁸ Build out costs per SF calculated for the Houston and Oklahoma districts—\$6.51 and \$40.51, respectively—vary greatly from the average build out cost per SF calculated for the entire Southwest Area. As a result, we applied the more conservative Area build out cost average to both districts.

¹⁹ While build out costs are negotiable and at times, paid for by the lessor, these costs ranged from \$0 per SF to \$120.92 per SF in the node studies analyzed.

Ownership of Facility and Term Years

We categorized all facilities in the district by ownership status – leased versus Postal Service-owned. We further grouped the leased properties by the number of term years remaining on the lease.

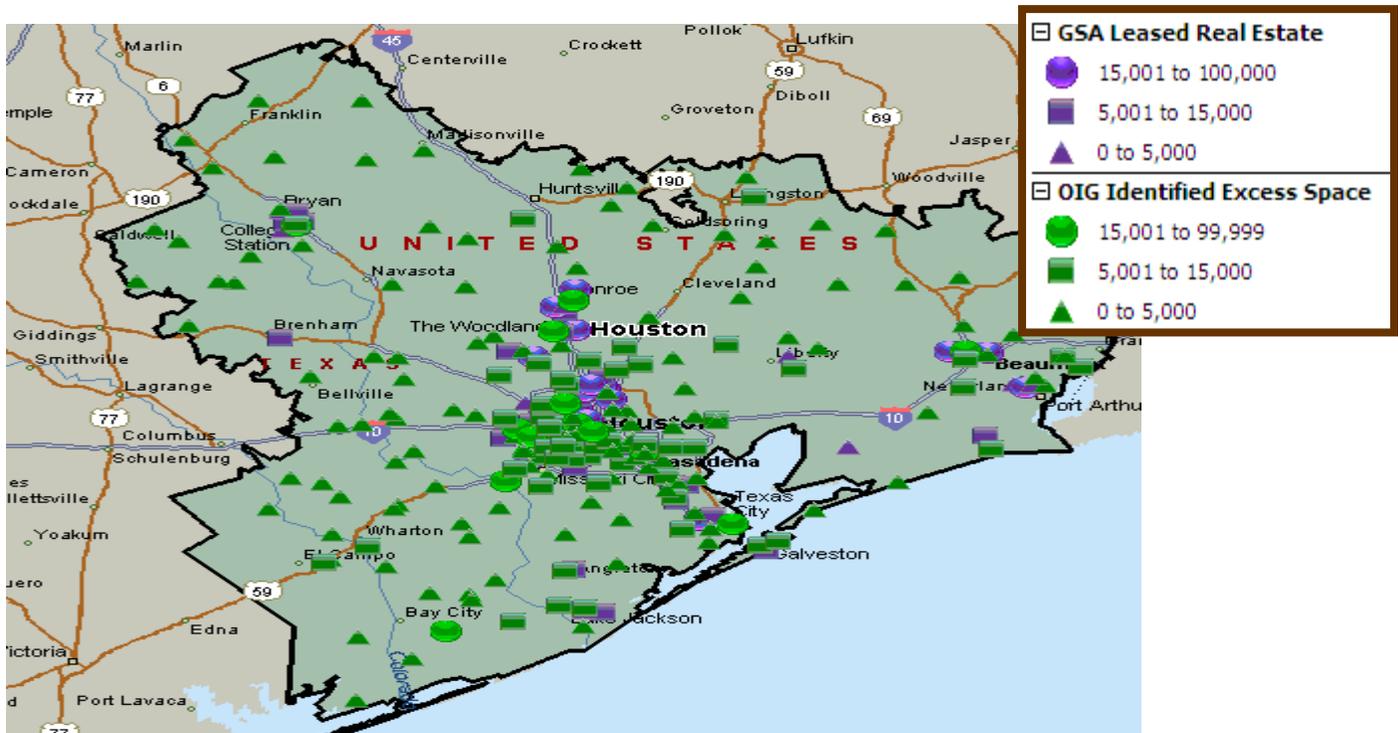
We calculated leases expiring before the end of FY 2011 based on the assumption that these leases would be renewed for the standard 5-year period. We calculated leases expiring after October 1, 2011 for the remaining lease term. We calculated owned facilities over a period of 7.3 years, which was the historical national average lease term.

Sublease Efficiency Rate

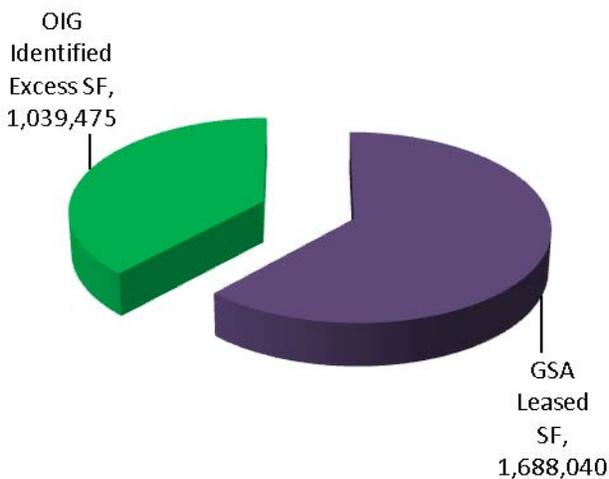
We identified the national commercial property vacancy rate from the National Realty Association for industrial and retail space as 13.3 percent, so we reduced the net present value savings realization to an 86.7 percent “success rate.”

**APPENDIX D: GSA-LEASED PROPERTIES
COMPARED TO POSTAL SERVICE EXCESS SPACE**

Houston District

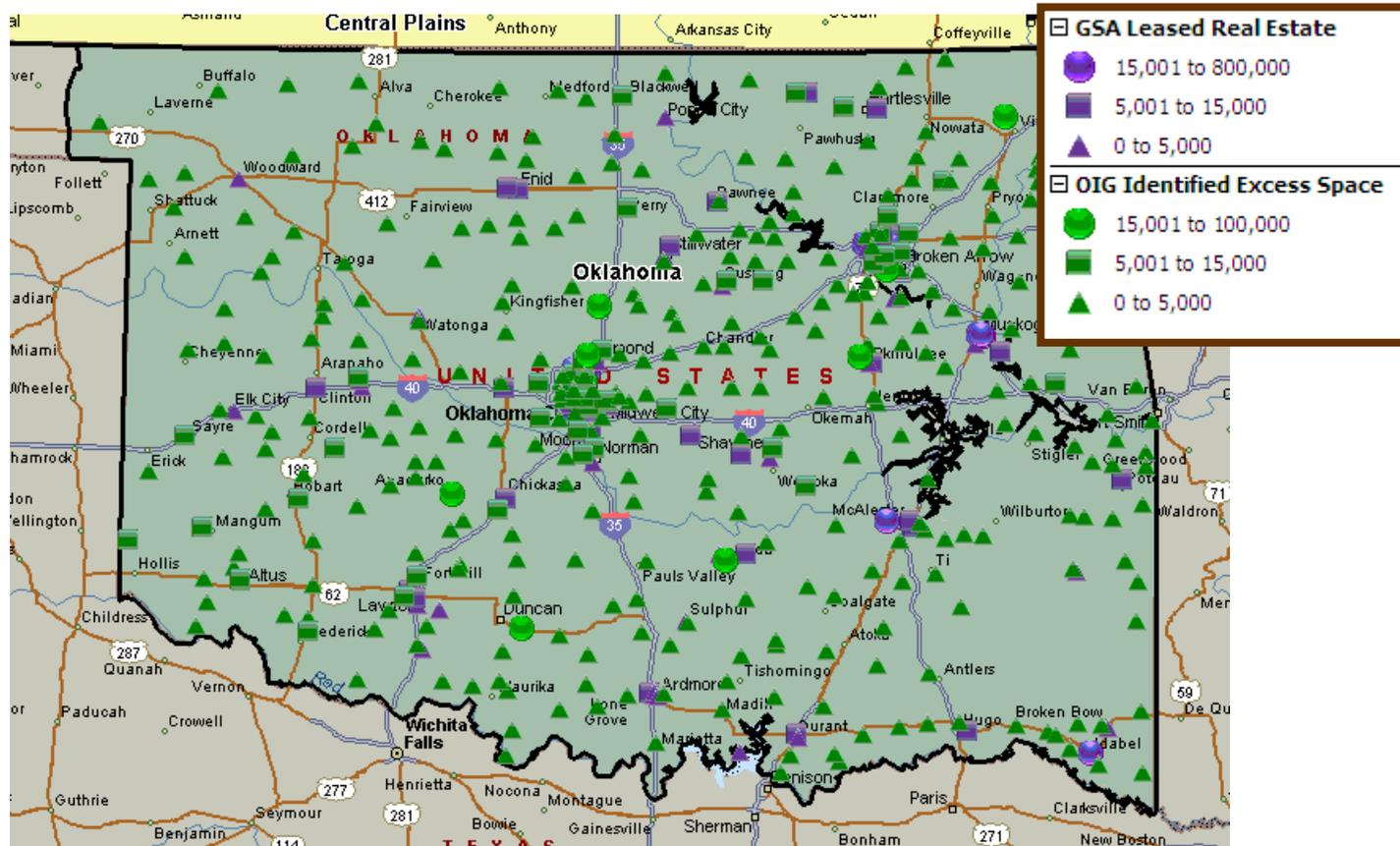


The pie chart illustrates the ratio of Postal Service excess space to GSA-leased commercial space. The table below provides additional analysis by placing the real estate into size categories to further assess supply versus demand.

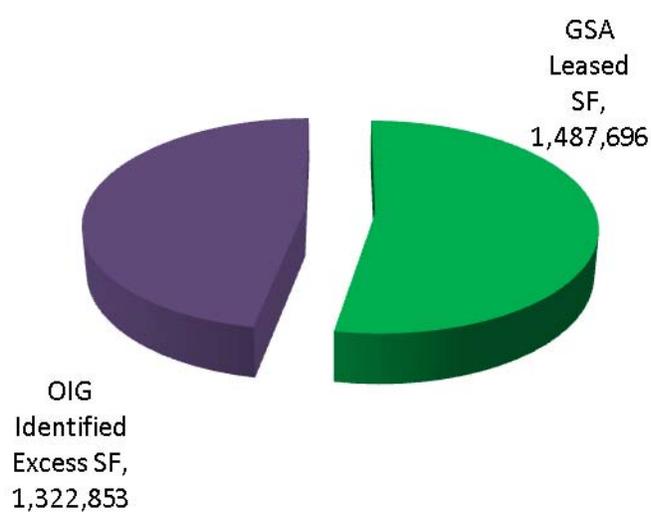


Building Size	GSA Leased Facilities	OIG Identified Excess
1,000	8	55
5,000	23	76
10,000	30	34
20,000	23	37
30,000	13	0
40,000	9	1
50,000	2	0
More	3	0
Total Count	111	203

Oklahoma District



The pie chart illustrates the ratio of Postal Service excess space to GSA-leased commercial space. The table below provides additional analysis by placing the real estate into size categories to further assess supply versus demand.



Building Size	GSA Leased Facilities	OIG Identified Excess
1,000	12	188
5,000	42	130
10,000	34	34
20,000	12	9
30,000	6	5
40,000	2	2
50,000	1	0
More	6	2
Total Count	115	370

APPENDIX D: MANAGEMENT'S COMMENTS

LINDA J. WELCH
VICE PRESIDENT, SOUTHWEST AREA OPERATIONS



February 16, 2011

LUCINE M. WILLIS
DIRECTOR AUDIT OPERATIONS
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SUBJECT: Facility Optimization: Southwest Area, Report Number DA-AR-11-DRAFT

Management appreciates the efforts the Office of Inspector General (OIG) has taken in regards to facility optimization in the Southwest Area. We agree that optimization of current facility infrastructure is a critical and an important initiative within the postal service. The following is in response to the above subject audit and management's comments on the findings.

Management is in full agreement that excess space exists in a number of facilities and it is the reason why the optimization program was started by the Facilities Department over two years ago. In addition, management agrees that the policy written in the ASM Section 517, is not followed and is ineffective. This is due to the changes in organizational structure and responsibilities since it was written in 1999, which rendered this section obsolete.

A different approach other than the ASM 517 to manage excess space is needed. This section will be revised and we will adjust our systems and the ASM to align to today's structure and processes which addresses the two recommendations made by the audit.

Regarding the findings of the audit, management disagrees with the amount of excess space and potential revenue based on the following:

1. The methodology utilized to determine existing usable excess space in facilities.
2. Inaccurate data and cost factors utilized to calculate the potential revenue

The following are the basis of management's disagreement as outlined:

1. Methodology

As stated in the audit, management disagrees with the methodology utilized in determining excess space. This disagreement was raised in discussions with the OIG prior to the first release of this audit and in meetings that were held with the OIG prior to the reissuance of this audit.

The major concern is that the methodology utilized is based on applying the current Small Standard Building Design (SSBD), which is intended for construction of new, under 10,000 squarer feet, one-story facilities with today's standards and efficiencies, and applying it against existing facilities constructed or leased over the past 80 years with very different standards, construction, layout and utilization.

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The OIG methodology takes the overall net interior square footage of the existing facilities and subtracts the overall net square footage of the SSBD (earned) and calls the delta "excess." However, this methodology does not include allowances for:

- A. Unusable space such as basements, corridors etc., the audit treats every square foot in the building as usable and leasable.
- B. Existing functions not included in the SSBD design, such as administrative district office, training, caller service, etc.
- C. Inefficiencies in current building layout due to multiple floors, stairs, elevators, columns, redundant support space required on each floor due to code requirements.
- D. Historic nature of some of the buildings that hinders the possibility of making changes.
- E. Parking and dock space requirements.
- F. Large inflexible retail lobbies.

Houston, TX – P&DC:



Multi Story Facility



Administrative Space



Unleasable Basement

Management's Recommended Methodology:

Because every building is different and has a variety of the above items to contend with, Management recommends that the OIG review each specific building and determine usable excess space after making allowances for the items listed above.

2. Inaccurate Data and Cost Factors

The audit states that over 2.3 million square feet of excess space exist in the Houston and Oklahoma Districts with a potential to realize \$99,618,007 over typical and remaining lease terms.

The OIG also provides two specific recommendations for the \$99,618,007 whereby, "Funds could be used more efficiently by implementing recommended actions."

Management disagrees with these findings because of the following:

- A. The first page of the audit states, "The two districts analyzed in the Southwest Area use 885 facilities covering nearly 7 million square feet (SF) of interior space for its delivery and retail operations." Based on eFMS inventory data, this number should be 920 buildings and utilizes 9,417,496 square feet.
- B. Page 3 of the audit states, "The Southwest Area has three approved optimization studies in the Oklahoma District and five in the Houston District." The number that was approved for the Oklahoma District is 4 (two in FY-09, one in FY-10 and one in FY-11). The number approved for the Houston District is 4 (all approved in FY-10) and one currently pending Area Vice President approval.
- C. The amount of usable excess square footage is not correct due to the methodology as described in Section 1 Methodology above.
- D. The OIG states that the Value Assigned to Excess Space is \$7.34 /SF for Oklahoma and \$8.51 /SF for Houston. The underlying premise is that if the Postal Service can rent the space for this rental, then the space can be sublet at this rental. Normally, sublet space is short term in nature and is rented at a deep discount to the overall market. Real estate professionals report discounts of 50% for sublease space. Comparisons to GSA lease rates are only applicable if you are renting to the GSA. The GSA lease rates quoted for Oklahoma and Houston appear to be the rental that GSA demands of tenants in their buildings. There is no evidence that GSA would consider paying \$17.57 /SF plus electric and maintenance. The total would equate to \$19.87 /SF (\$17.57 + \$1.29 + \$1.01), comparable to Class A office space in Oklahoma City. Postal sublease space would not be comparable to Class A office space.
- E. The audit report uses a national average vacancy rate from National Realty Association of 13.3%. While the data is of interest to the subject at hand, the question is actually, what would the average vacancy rate be for sublease space, say in rural Oklahoma. Management doubts that it would be comparable to 13.3%. The OIG audit failed to consider a reasonable absorption period for sublease space in Oklahoma. If the listing period is more than 12-months, a lease with four remaining years would reflect a reduced cash flow by 25%. If the GSA has no need for the sublease space then a leasing commission cost would need to be included. This cost was not in the analysis.
- F. The finish allowance that was used in the analysis is \$15.48 /SF. Management believes that carpet and paint for space that has already been demised will cost in the neighborhood of \$20.00 /SF. If demising walls and lighting and HVAC need to be added, the price will be dramatically higher. Management believes \$100 /SF in some locations would not be unusual for converting a portion of a Postal workroom to office space. Note: We could not find the cost to restore the space to its original configuration at the end of the lease. Normally, demolition of an office configuration would cost \$5.00 /SF.
- G. As previously stated, Management believes the estimated quantity of excess space is far less than what was estimated. However, if the Postal Service has 1,322,853 SF of excess space in Oklahoma, its outlease would be one of the largest real estate leasing projects in the state. The cost to finish the space, lease the space and finally restore the space at the end of the lease would likely be in excess of \$35,000,000 in anticipation of getting a solid tenant for four to eight years. This kind of investment is normally called real estate speculation. Because of the risk, it would normally be discounted at far higher than rate than 3.875%. Management doubts that any investor would pay the Postal Service \$44,645,698 for the excess space in Oklahoma.

- H. Build-Out Cost: To build out the excess space and make it available to sublease, the number utilized was the total line 63 budget numbers from completed node studies divided by the square footage reduction. This is not an accurate method for determining the construction cost, because the node studies are based on terminating leases, selling owned buildings, and minimum renovation for the facilities gaining carriers and building alternate retail. The average square foot cost for this work cannot be used for Build-Out cost for subleasing buildings, because the scope of work is completely different in these two scenarios. Management recommends that the OIG review each specific building to determine the following:
- a. The total usable square footage.
 - b. The practicality of capturing the usable square footage in one area(s) by moving and consolidating operations in the building and insuring the security of the mail is met.
 - c. Cost to accomplish b.

Potential Revenue:

Management believes the accurate way to calculate potential revenue is, first applying the following formula we use in our node studies which is:

Potential Revenue = (Usable excess square footage X sublease value per square foot) minus (Total cost required to achieve this revenue)

Then adjust for the values of maintenance and utility savings.

We described the correct method to calculate the accurate available excess square footage. When it comes to the value of subleasing the excess square footage, the only way to determine this value is by analyzing the real estate market. This must include the possibility of subleasing, the duration of subleasing, and the square foot value of such a sublease. Also, the cost of tenant improvement must be included. Further discussion of market conditions is covered in a later section of this response.

The correct methodology to calculate the cost of making the space available is described in Section 2H above.

The above makes the assumption that we would sublease all of the excess square footage. However, in many cases we have no intentions of renewing the lease and vacating the building is the best financial alternative based on today's market.

Since the \$99,618,007 over typical and remaining lease terms was not calculated according to our formula, we are unable to agree or disagree with this number.

Market Conditions:

Regardless of how much excess space exists, there needs to be a market for the space. The vast majority of postal facilities fall into the industrial/commercial real estate market. Unfortunately, it is this sector that is experiencing a severe downturn. Vacancy rates are high and demand is low.

Facilities engaged the largest six (6) real estate brokerage firms in the country and all have confirmed that the property values are dropping; lease rates and demand are declining. As a result in general, our landlords are not accepting early lease terminations and our excess space must compete in a saturated market. Under this scenario, it makes it impossible for us, in most cases, to achieve any positive financial results by subleasing due to the capital improvement required to make the excess space available and the high demand for tenant improvement.

Conclusions:

- A. Regarding the audit recommendations:
 - 1. Management will develop a more accurate process and proper documentation for identifying and reporting excess space.
 - 2. Management will include additional metrics to track dates and conditions of excess space. This will be part of a national process.

Both of these actions will be completed by end of Quarter 2, Fiscal Year 2011.

- B. Actions already taken by management:
 - 1. Management believes that the current facilities optimization approach of focusing on the excess workroom space is an effective method for finding potential excess square footage. By currently focusing on facilities that are 10,000 square feet and greater, as opposed to all buildings in the inventory, it allows us to capture the largest opportunities for excess space that is usable.

National Data	# of Buildings	% of Buildings	Square footage	% of SF
Buildings under 10k SF	28,015	84%	68.1 million	24%
Buildings over 10k SF	5,327	16%	221.6 million	76%

- 2. This optimization process is a nationwide effort where by we segment and review our facilities for excess space. Our inventory is segmented by:
 - a. Leased verses owned buildings
 - b. Delivery only facilities
 - c. GSA leased space
 - d. Expiring leases
 - e. Current market conditions

- 3. Buildings over 10,000 square feet were measured to ascertain the correct square footage per function within the facility. Based on this data, we are now able to determine what space is needed for the current operations in the facility and how much is potential excess space. After finding these candidates for excess space, a node study is developed to verify the feasibility.

The node study standard operating procedure for the optimization program includes:

- a. Establish and schedule a node study to analyzes all alternatives and associated costs/savings and complete schedule for all tasks
- b. Review all market conditions to determine financial viability of utilization of the space, disposal of the facility or sublease excess space
- c. Visit potential sites to verify all applicable costs

- d. Determine best financial alternative for utilization or disposal of the excess space and obtain all necessary management approvals
- e. Track time durations from final study approval of the action to ebuy notification for disposal
- f. Establish and track disposal schedule

Generated out of optimization studies nationwide, we currently have over 120 properties on the market for sale and have scheduled to terminate 250 leases.

As a positive outcome of node studies in the Southwest Area, below are ongoing actions for two facilities that are listed on the OIG audit:

Tulsa, OK Downtown Station (MPO)

OIG excess SF: 213,636

Disposal SF: 378,662

NPV \$5.65 million

Sam Houston Carrier Annex

OIG excess SF: 18,706

Active node study pending AMP

(Plan – move 23 city routes from River Oaks Station to Sam Houston)

Management believes the Facilities optimization process, along with other national initiatives, will continue to allow us to identify usable excess space in our portfolio and extract the maximum value for the postal service out of it.

Management also looks forward to working with the OIG to accomplish this very important initiative.



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