



OFFICE OF INSPECTOR GENERAL

UNITED STATES POSTAL SERVICE

Postal Service Management of CBRE Real Estate Transactions

Audit Report

Report Number
SM-AR-15-003

April 22, 2015





OFFICE OF INSPECTOR GENERAL

UNITED STATES POSTAL SERVICE

Highlights

Background

Under a June 2011 contract, CBRE Group, Inc. (CBRE) is the sole provider of real estate management services for the U.S. Postal Service. These services include marketing and sale of properties and conducting lease negotiations. In fiscal years 2012 and 2013, CBRE marketed 49 property sales totaling about \$118 million and conducted 1,698 lease negotiations.

The U.S. Postal Service Office of Inspector General (OIG) issued two reports on the Postal Service's contract with CBRE and a third addressing the Postal Service's historic properties. This report, which considers Postal Service management of CBRE real estate transactions, is the fourth in a series evaluating Postal Service real estate management. Our objective is to assess the Postal Service's internal controls over CBRE real estate property sales and lease negotiations.

What The OIG Found

The Postal Service could improve its management of CBRE real estate transactions. Management continues to allow CBRE to collect commissions from lessors for lease negotiations in addition to payments from the Postal Service based on performance targets for lease renewals. Management also allows dual agency transactions, enabling CBRE to represent and negotiate for both the Postal Service and buyers or lessors. These actions are inherently risky and create conflicts of interest whereby CBRE may not negotiate property sales and

lease transactions in the Postal Service's best interest or may capture opposing party fees from the Postal Service.

Leases

Lessors in the past often negotiated leases directly with the Postal Service without representation. However, since the start of the CBRE contract, some lessors have told the OIG of having been approached by CBRE agents regarding required payment of a commission to CBRE. In these instances, the lessors expressed that they were told if they did not agree to pay CBRE a commission, CBRE, as the Postal Service's representative, would find another building and discontinue the lease. This does not provide the Postal Service with best value from such a contractor.

We also received allegations that CBRE announced, rather than negotiated, the Postal Service's lease rate to lessors. CBRE informed the lessors they could "recover" commission fees from the Postal Service's increased rents to them. CBRE represented that the fee would, in effect, be paid by the Postal Service. If true, the contractor is causing the Postal Service to pay for CBRE to negotiate against the Postal Service.

CBRE made the process for commissions appear to be mandatory despite the fact that the Postal Service had no such requirement. This arrangement allowed CBRE to negotiate with no parties present, representing both the lessor and the

Postal Service and being paid by both. Postal Service officials were aware that CBRE increased the rent amount to include commissions and indicated this was an industry standard—even though CBRE’s contract states that the Postal Service will not pay CBRE commissions for negotiating lease transactions, if the lessor refuses to pay them.

We analyzed all Postal Service leases expiring between October 2012 and September 2016 and found CBRE collected lessor commissions on 3,405 of the 4,718 leases it renegotiated. These commissions totaled \$20.6 million. CBRE can also collect payments from the Postal Service based on performance targets for lease renewals.

Of 4,718 leases CBRE negotiated for the Postal Service, the average annual rent increase was \$2,792 higher than the prior lease rate. This is more than three times higher than the Postal Service’s average rent increase of \$773 for the 11,075 leases that the Postal Service renegotiated without CBRE. As a result, the Postal Service could be overpaying an estimated \$9.5 million per year for leases already negotiated by CBRE.

Further, CBRE renegotiated 57 of the 4,718 Postal Service leases at a rate increase of 200 percent or more than the previous lease rate. We referred the 57 CBRE lease transactions and the lessors’ allegations that CBRE is including commission fees in rents paid by the Postal Service to the OIG’s Office of Investigations for further review.

Based on our review of lease negotiations, we found:

- The Postal Service did not accurately identify CBRE as the lease negotiator in the facilities management system for 1,049 leases, with annual rents totaling about \$59 million. Tracking leases CBRE negotiates is essential for properly managing these transactions.
- For 30 randomly selected lease negotiations that we reviewed, totaling about \$4.7 million in annual rents, 26 did not have supporting documentation to capture the proposed lease rate to review against the final negotiated rate. The Postal Service did not require CBRE to record initial offers, which are necessary to ensure the transparency



Contributing Factors



Hover over the contributing factors for more information

and reasonableness of the negotiated lease amounts. Additionally, documentation for market rent rates and analyses for all 30 were not centrally maintained in the facilities management system.

- Postal Service employees did not itemize the detailed expenses invoiced by CBRE in the facilities management system for 111 of the 246 payments made to CBRE for later analysis. The 111 payments totaled about \$466,000. Itemization is needed to enable management review.

Property Sales

We also found problems with 14 of the 21 sale transactions we reviewed. Specifically:

- All of the properties were sold within the goal of 90 percent or greater of the appraised values; However, CBRE solicited the appraisals. There were also shortcomings in the appraisal methodology for seven of the 21 properties that could have affected the estimated market values. Postal Service employees did not detect these discrepancies and did not complete checklists, as required, for six of the seven properties to ensure the questionable appraisals were revised.
- Employees could not locate a file to support the sale of one property for \$2 million and did not maintain appraisal reviews to support the sale of two properties totaling about \$6.4 million.
- Eight properties that sold for about \$15.9 million were incorrectly coded as “active” (not sold) in the facilities management system.

For five properties, we also found potential relationships between the buyer and CBRE. We referred these transactions to the OIG’s Office of Investigations for further review. Four of the five properties were sold at or above their appraised value, although appraisals for three of the properties were questionable.

Without proper oversight of real estate transactions, the Postal Service is at increased risk of having inaccurate valuation of its marketed and leased properties. Documenting and recording transactions in the Postal Service’s facilities management system is necessary to ensure transparency in the negotiation process and related costs.

Finally, management did not fully implement a prior OIG recommendation to designate contracting officer’s representatives to monitor contract performance and approve payments to CBRE. Between July 1, 2013, when management agreed to implement the prior recommendation, and September 30, 2013, employees not designated as contracting officer’s representatives, authorized 12 payments, totaling about \$63,000. Because the contracting officer or a designated contracting officer representative did not approve payment authorizations, there is an increased risk of poor contract oversight, unauthorized expenditures, and contract changes.

What The OIG Recommended

We recommended management terminate and recompute the current real estate services contract. In addition, we recommended management, in the interim, modify the CBRE contract to prohibit CBRE from collecting commissions from opposing parties and prohibit dual agency representation. We also recommended management, in the interim, notify lessors they are not required to pay commissions.

We also recommended management train employees to comply with the requirement to review appraisals independent of CBRE and implement revisions to the appraisal review checklist to ensure it is sufficient to detect technical errors in appraisals.

Further, we recommended that management update record management requirements, implement Postal Service policy that requires employees to consistently enter real estate transactions into the facilities management system, and instruct the contracting officer to ensure the proper certification of payment authorizations.

Transmittal Letter



OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

April 22, 2015

MEMORANDUM FOR: TOM A. SAMRA
VICE PRESIDENT, FACILITIES

A rectangular box containing a handwritten signature in black ink that reads "John E. Cihota". There is a small black dot in the upper right corner of the box.

FROM: John E. Cihota
Deputy Assistant Inspector General
for Finance and Supply Management

SUBJECT: Audit Report – Postal Service Management of
CBRE Real Estate Transactions
(Report Number SM-AR-15-003)

This report presents the results of our audit of the U.S. Postal Service's Management of CBRE Real Estate Transactions (Project Number 14YD001SM000).

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

Attachment

cc: Corporate Audit and Response Management

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Findings

Under a June 2011 contract, CBRE is the sole provider of real estate management services for the Postal Service.

In fiscal years (FYs) 2012 and 2013, CBRE marketed 49 property sales totaling about \$118 million and conducted 1,698 lease negotiations for the Postal Service.

The Postal Service could improve its management of CBRE real estate transactions.

Introduction

This report presents the results of our self-initiated audit of the U.S. Postal Service's management of CBRE Group, Inc. (CBRE) real estate transactions (Project Number 14YD001SM000). Our objective was to assess the Postal Service's internal controls over CBRE-real estate property sales and lease negotiations. We also followed up on a prior recommendation that the Postal Service designate contracting officer's representatives (COR) to monitor CBRE's contract performance and approve payments. See [Appendix A](#) for additional information about this audit.

Challenges in the economy, shifts in technology, and other factors have led to a change in the Postal Service's real estate goals and objectives with regard to acquiring, building, and expanding facilities to support operations. Currently, the Postal Service's Facilities organization focuses on consolidating and disposing of excess space. Under a June 2011 contract, CBRE is the sole provider of real estate management services for the Postal Service. These services include marketing and sale of properties and conducting lease negotiations. In fiscal years (FYs) 2012 and 2013, CBRE marketed 49 property sales totaling about \$118 million and conducted 1,698 lease negotiations for the Postal Service. As the largest real estate owner in the world, CBRE has one of the broadest industry platforms. In 2013, CBRE was responsible for more than \$223.2 billion in property sales and lease transactions globally and managed more than 3.5 billion square feet of commercial properties and corporate facilities.

We judgmentally selected 21 sold properties to review based on a comparison of each property's sales price to appraised value,¹ book value,² assessed value,³ and broker's opinion of value.⁴ Two of the sales transactions were dual agency⁵ transactions. We reviewed eight dual agency lease transactions and another 30 randomly selected lease transactions.

The U.S. Postal Service Office of Inspector General (OIG) issued two reports⁶ on the Postal Service's contract with CBRE and a third report addressing the Postal Service's historic properties.⁷ This report, which addresses Postal Service management of CBRE real estate transactions, is the fourth in a series evaluating Postal Service real estate management.

Conclusion

The Postal Service could improve its management of CBRE real estate transactions. Management continues to allow CBRE to collect commissions from lessors for lease negotiations in addition to payments from the Postal Service based on performance targets for lease renewals. Management also allows dual agency transactions, enabling CBRE to represent and negotiate for both the Postal Service and the buyer or lessor. These actions are inherently risky and create conflicts of interest whereby CBRE may not negotiate property sales and lease transactions in the Postal Service's best interest or may capture opposing party fees from the Postal Service.

¹ The value placed on a property at a given point in time by a professional appraiser.

² The value placed on a property based on its original cost less any depreciation, amortization, or impairment costs, made against the asset.

³ The value placed on a property by an assessor's office for the purpose of determining property taxation. The appraised value of a property should be a better representation of the property's fair market value.

⁴ The value placed on a property by a broker based on an educated "best guess" as to a property's current market value.

⁵ Dual agency occurs when the listing broker represents both the seller and the buyer.

⁶ *Contracting of Real Estate Management Services* (Report Number [SM-AR-13-001](#), dated June 12, 2013) and *Risks Associated With CB Richard Ellis, Inc. Contract* (Report Number [SM-MA-14-003](#), dated February 12, 2014).

⁷ *Preservation and Disposal of Historic Properties* (Report Number [SM-AR-14-004](#), dated April 16, 2014).

CBRE made the process for commissions appear mandatory despite the fact that the Postal Service had no such requirement.

Between October 2012 and September 2016, CBRE collected lessor commissions on 3,405 of 4,718 leases it renegotiated.

CBRE renegotiated 57 of the 4,718 Postal Service leases at a rate increase of 200 percent or more than the previous lease rate.

Leases

Lessors in the past often negotiated leases directly with the Postal Service without representation. However, since the start of the CBRE contract, some lessors have told the OIG of having been approached by CBRE agents regarding required payment of a commission to CBRE. In these instances, the lessors expressed that they were told if they did not agree to pay CBRE a commission, CBRE, as the Postal Service's representative, would find another building and discontinue the lease. This does not provide the Postal Service with best value from such a contractor.

We also received allegations that CBRE announced rather than negotiated the Postal Service's lease rate to lessors. CBRE informed lessors they could "recover" commission fees from the Postal Service's increased rents to them. CBRE represented that the fee would, in effect, be paid by the Postal Service. If true, the contractor is causing the Postal Service to pay for CBRE to negotiate against the Postal Service.

CBRE made the process for commissions appear mandatory despite the fact that the Postal Service had no such requirement. This arrangement allowed CBRE to negotiate with no parties present, representing both the lessor and the Postal Service and being paid by both. Postal Service officials were aware that CBRE increased the rent amount to include commissions and indicated this was an industry standard—even though CBRE's contract states that the Postal Service will not pay CBRE commissions for negotiating lease transactions, if the lessor refuses to pay them.

Between October 2012 and September 2016, CBRE collected lessor commissions on 3,405 of 4,718 leases it renegotiated. These commissions totaled \$20.6 million. CBRE can also collect payments from the Postal Service based on performance targets for lease renewals.

Of the 4,718 leases CBRE negotiated for the Postal Service, the average annual rent increase was \$2,792 higher than the prior lease rate. This is more than three times higher than the average rent increase of \$773 for the 11,075 that the Postal Service renegotiated without CBRE. The Postal Service could be overpaying an estimated \$9.5 million annually or \$38 million over 4 years for leases already negotiated by CBRE.

Further, CBRE renegotiated 57 of the 4,718 Postal Service leases at a rate increase of 200 percent or more than the previous lease rate. We referred the 57 CBRE lease transactions and the lessors' allegations that CBRE is including commission fees in rents paid by the Postal Service to the OIG's Office of Investigations for further review.

Based on our review of lease negotiations, we found that:

- The Postal Service did not accurately identify CBRE as the lease negotiator in the electronic Facilities Management System (eFMS)⁸ for 1,049 of 4,718 leases, with annual rents totaling about \$59 million. Tracking leases that CBRE negotiates is essential for properly managing these transactions.
- Twenty-six of 30 randomly selected lease negotiations that we reviewed, totaling about \$4.7 million in annual rent, did not have supporting documentation to capture the proposed lease rate for review against the final negotiated rate. The Postal Service did not require CBRE to record initial offers, which are necessary to ensure the transparency and reasonableness of the negotiated lease amounts. Additionally, documentation for market rent rates and analyses for all 30 were not centrally maintained in eFMS.

⁸ The eFMS is the official Postal Service record for real property inventory and management.

All 21 sold properties we reviewed met the sales goal of 90 percent or more of their appraised value; however, CBRE solicited the appraisals.

Without proper oversight of real estate transactions, the Postal Service is at increased risk of inaccuracies in the valuation of marketed and leased properties.

Management did not fully implement a prior OIG recommendation to designate CORs to monitor contract performance and approve payments to CBRE.

- Postal Service employees did not itemize the detailed expenses CBRE invoiced in eFMS for 111 of 246 payments made to CBRE for later analysis. The 111 payments totaled about \$466,000. Itemization is needed to enable management review.

Property Sales

We also found problems with 14 of the 21 property sales we reviewed. Specifically:

- All of the properties met the sales goal of 90 percent or more of their appraised value; however, CBRE solicited the appraisals. There were also shortcomings in the appraisal methodology for seven of the 21 properties that could have affected estimated market values. Postal Service employees did not detect these discrepancies and did not complete checklists, as required, for six of the seven properties to ensure the questionable appraisals were revised.
- Employees could not locate a file to support the sale of one property for \$2 million and did not maintain appraisal reviews to support the sale of two properties totaling about \$6.4 million.
- Eight properties that sold for about \$15.9 million were incorrectly coded as “active” (not sold) in eFMS.

For five properties, we found potential relationships between the buyer and CBRE. We referred these transactions to the OIG’s Office of Investigations for further review. Four of the five properties were sold at or above their appraised value, although appraisals for three of the properties were questionable.

Without proper oversight of real estate transactions, the Postal Service is at increased risk of inaccuracies in the valuation of marketed and leased properties. Documenting and recording transactions in the Postal Service’s facilities management system are necessary to ensure transparency in the negotiation process and related costs.

Finally, management did not fully implement a prior OIG recommendation to designate CORs to monitor contract performance and approve payments to CBRE. Between July 1, 2013, when management agreed to implement the prior recommendation, and September 30, 2013, employees not designated as CORs authorized 12 payments, totaling about \$63,000. Because the contracting officer or a designated COR did not approve payment authorizations, there is an increased risk of poor contract oversight, unauthorized expenditures, and contract changes.

Continued Concerns with the CBRE Contract

We previously issued two reports on the Postal Service’s contract with CBRE identifying the need for the Postal Service to address conflict of interest concerns associated with the contract.⁹ Specifically, management continues to allow CBRE to collect commissions from lessors for lease negotiations. Management also allows dual agency transactions where CBRE represents both the Postal Service and the buyer or lessor. We believe these conflict of interest concerns continue to pose an increased risk to the Postal Service’s finances, brand, and reputation. With these two allowances available to CBRE, the Postal Service has no assurance that CBRE is providing the Postal Service with the best value in lease negotiations and the sale of Postal Service property.

⁹ *Contracting of Real Estate Management Services* (Report Number [SM-AR-13-001](#), dated June 12, 2013), and *Risks Associated With CB Richard Ellis, Inc. Contract* (Report Number [SM-MA-14-003](#), dated February 12, 2014).

Lease Negotiations

Lessors in the past often negotiated leases directly with the Postal Service without representation. However, since the start of the CBRE contract, some lessors have told the OIG of having been approached by CBRE agents regarding required payment of a commission to CBRE. In these instances, the lessors expressed that they were told if they did not agree to pay CBRE a commission, CBRE, as the Postal Service's representative, would find another building and discontinue the lease. We also received allegations that CBRE announced, rather than negotiated, the lease rate the Postal Service would pay. CBRE informed lessors that they could "recover" these fees from the Postal Service's increased rents. CBRE made the process for commissions appear mandatory despite the fact that the Postal Service had no such requirement. This arrangement allowed CBRE to negotiate in its own best interest by, in essence, representing both the lessor and the Postal Service.

These practices increase the Postal Service's financial risk as lessors will consider commission fees a cost of doing business with the Postal Service and, thereby, increase rental rates to include these fees. Prior to the CBRE contract, lessors negotiated directly with the Postal Service regarding lease terms and did not have to pay commission fees. The Postal Service's contract with CBRE states the Postal Service will not pay commissions for negotiating leases, if the lessor refuses to pay them; however, Postal Service management allowed CBRE to include commissions in the lease rent that the Postal Service paid because the total lease amount, with commissions, was within the market rent valuation.¹⁰ Management stated it was an industry standard to include commissions in market rent. We did not identify evidence to substantiate this claim.

We analyzed 15,793 renegotiated Postal Service leases with renewal dates falling between October 2012 and September 2016.¹¹ CBRE collected commissions on 3,405 of 4,718 leases it renegotiated, with commissions totaling \$20.6 million.

Of the 4,718 leases CBRE negotiated, the average annual rent increase was \$2,792 (8.07 percent) more than the prior lease rate. The Postal Service's average rent increase was \$773¹² (3.53 percent) for the 11,075 leases it renegotiated. CBRE's average lease rate increase was more than three times higher than the Postal Service's increase. As a result, the Postal Service could be overpaying an estimated \$9.5 million annually for leases CBRE negotiated. We identified \$38,101,994 in lease payments the Postal Service is at risk of overpaying for FYs 2013 to 2016 by having CBRE negotiate its leases. See Table 1 for a summary of the Postal Service's average lease rate increase.

Table 1. The Postal Service Average Lease Rate Increase

Conducted Renegotiation	Number of Leases Renegotiated	Average Lease Rate Increase	Average Percent Increase
CBRE	4,718	\$2,792	8.07%
Postal Service	11,075	\$773	3.53%

Source: OIG analysis of Postal Service and CBRE data.

¹⁰ Market rent is defined as "the estimated amount for which a property, or space within a property, should lease on the date of valuation between a willing lessor and a willing lessee."

¹¹ The renewal date represents the start date of the renegotiated lease.

¹² If the Postal Service handled the 4,718 leases that CBRE renegotiated, it would have cost about \$3.6 million (4,718 x \$773), whereas it cost CBRE \$13.1 million (4,718 x \$2,792).

Allowing CBRE to charge lessors' commissions gives the appearance of impropriety and creates a conflict of interest because the supplier (CBRE) earns its revenue from lessors and not the Postal Service and, if lessors pay a higher rent, the supplier will receive a higher commission.

We also identified 57 leases where CBRE negotiated a rate increase of 200 percent or more than the previous lease rate.¹³ Because the percentage increases were significantly higher than CBRE's average lease rate increase of 8.07 percent, we have referred these transactions to the OIG's Office of Investigations for further review.

Allowing CBRE to charge lessors' commissions gives the appearance of impropriety and creates a conflict of interest because the supplier (CBRE) earns its revenue from lessors and not the Postal Service and, if lessors pay a higher rent, the supplier will receive a higher commission. Therefore, CBRE may be unduly motivated to increase its revenue by conducting lease negotiations that do not represent the Postal Service's best interest. As a general rule, CBRE is presumed to owe a fiduciary duty, and a duty of loyalty, to the Postal Service. Any conduct that violates this duty, such as negotiating with lessors less aggressively, on the understanding that the lessor would likely roll commission costs into lease pricing while CBRE collected its commission, would be grounds for terminating the CBRE contract.

Lease Records

The Postal Service cannot readily identify leases negotiated by CBRE. The lease negotiator is responsible for recording whether CBRE or the Postal Service handled the lease in eFMS. However, CBRE or Postal Service employees did not always complete this field. Tracking leases that CBRE negotiates is essential for properly managing and analyzing these transactions. As a result, we estimate potential data integrity issues valued at \$59,226,012,¹⁴ for the 1,049 leases negotiated by CBRE but not identified in eFMS. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.

We randomly selected 30 lease transactions with annual lease amounts totaling \$4.7 million that CBRE negotiated and found that the Postal Service did not capture crucial data elements or centrally maintain complete records to support its oversight of those transactions. Specifically, 26 of the 30 did not have supporting documentation to capture the proposed lease rate for review against the final negotiated rate. Market rent and rent analysis results were inconsistently recorded in the supporting lease files for all 30 leases reviewed. In addition, Postal Service employees did not itemize the detailed expenses CBRE invoiced in the facilities management system for 111 of the 246 payments made to CBRE for later analysis. The 111 payments totaled \$466,000.

Initial Lease Rate Offer

Supporting documentation for 26 of the 30 leases we reviewed did not capture the lessor's or Postal Service's initial lease rate offer. The remaining four leases captured this information in the list of lease actions, the negotiation summary, or the paper file.¹⁵ The Postal Service did not require CBRE to record both parties' initial offers in the negotiation summary because it believed the information was irrelevant. However, this information is necessary to ensure the transparency and reasonableness of the negotiated lease amounts. Failing to capture this information hinders the Postal Service's ability to review the contractor's actions during the negotiation process.

¹³ The total lease rate increased by about \$3.7 million for these 59 leases.

¹⁴ We estimate the value of the data integrity issues at \$61,333,422. However, we deducted \$2,104,410 to avoid duplication with questioned costs.

¹⁵ The list of lease actions is an analysis screen within the eFMS that provides a detailed description of actions taken during the leasing process. The negotiation summary is a supporting document used to record the negotiations of the lease and is recorded in eFMS and the hard copy lease file.

Market Rent

Market rent was not centrally maintained in the eFMS list of lease actions for all 30 leases we reviewed. We subsequently identified market rent for 26 of the 30 leases through analyzing information recorded in CBRE's Client Relationship Management System (CBRM),¹⁶ negotiation summaries, and paper files, but the market rent for the remaining four leases was not documented. Currently, the data populating the market rent field in the eFMS represents the market rate of the building if it were purchased, which is not relevant. Capturing market rent is necessary to determine the reasonableness of the negotiated rent value. Facilities planned to capture the correct market rental rate in eFMS by the end of calendar year (CY) 2014.

Rent Analysis Results

Rent analysis results were not centrally captured in the eFMS list of lease actions for all 30 leases we reviewed. Rather, information was recorded in multiple internal and external electronic systems and paper files. In September 2013, Facilities instituted a process change to capture the results of the rent analysis and other relevant information. A stamp records the name of the negotiator who conducted the transaction, the real estate specialist assigned to the project, the market rate, and whether the negotiated lease terms are above/at/or below market. Facilities' goal for automating the capture of this information was the end of CY 2014.

Postal Service policy¹⁷ does not provide sufficient documentation standards for recording lease transactions. A standardized documentation policy is necessary to provide controls over the verification of expenses and to ensure proper oversight and transparency of lease transactions negotiated by CBRE or any contractor. We consider \$4,677,662 as a data integrity error due to missing or inaccurate lease data recorded in eFMS for all 30 leases we reviewed. This amount does not represent actual losses the Postal Service incurred but rather incorrect data recorded in the eFMS.

Due Diligence Payments

Postal Service personnel did not itemize or fully explain due diligence amounts valued at about \$466,000 for 111 of the 246 payments made to CBRE. Specifically they did not provide a detailed explanation of the scope of work and expenses. Facilities personnel are not required to itemize expenses when creating supporting work order documentation; however, they received itemized invoices from CBRE and did not scan them into eFMS.

Failure to itemize due diligence supporting documentation weakens controls over the verification of expenses and creates business inefficiencies such as expending man-hours searching for additional records to substantiate due diligence costs. We consider \$465,941 as a data integrity error due to the lack of itemization of due diligence costs. This amount does not represent actual losses the Postal Service incurred but rather incorrect data recorded in the eFMS.

Property Sales Appraisals

For the 21 property sales transactions reviewed,¹⁸ the Postal Service met its sales goal of 90 percent or more of the properties' appraised value; however, CBRE managed the entire appraisal process. The appraisals were solicited by CBRE, prepared by contractors, and used to determine whether the sale price was acceptable to the Postal Service. To avoid conflicts of interest, the appraisal process is normally managed and performed by professionals not involved in negotiating sales and leases or by realtors marketing the properties.

¹⁶ CBRM is based on cloud-computing technologies and designed to synchronize a company's interactions with current and future customers.

¹⁷ *Implementing the RE-1 in Postal Real Estate Actions*. Section B-33, Lease Documentation.

¹⁸ CBRE represented the Postal Service and the buyer for two of the 21 disposal transactions.

Appraisals for seven of the transactions contained questionable financial analyses and comparisons to other properties that could have affected the credibility and reasonableness of the estimated market value.

We concluded that appraisals for seven of the transactions contained questionable financial analyses and comparisons to other properties that could have affected the credibility and reasonableness of the estimated market value.¹⁹ We did not calculate a revised appraised value for the seven properties due to the time lapse since the original appraisal and the cost to do a full appraisal. Instead, we focused on the adequacy of the appraisal methodologies.

- Appraisals for three of the properties in Richmond, VA; St. Paul, MN; and Shawnee, OK, did not contain market data for comparable properties sold; therefore, the Postal Service should have considered another approach to value.
- The appraisal for a property in West Jersey, NJ, contained mistakes in applying deductions to the market value. For example, the appraiser applied a deduction for functional obsolescence²⁰ twice.
- The appraisal for a property in Gilbert, AZ, was flawed due to overstated estimates of expenses based on market data. The appraiser was also conservative in determining the value per square foot of the property compared to similar properties sold.
- The appraisal for a property in York, PA, included an appraiser’s estimate of market value that was speculative and not well-supported because an analysis of financial feasibility was not performed, as required.
- The appraisal for a property in Forest City, NC, did not include sufficient evidence to support the significant adjustments made to comparable land sales or the estimate of market value. For example, the value of a comparable sale was adjusted downward by 115 percent.

Postal Service personnel did not detect discrepancies in these seven appraisals and did not complete checklists, as required, to document the review for six of the seven properties. Instead, they relied on contractors²¹ hired to review the appraisal to complete the checklists. See Table 2 for a summary of disposal appraisal discrepancies.

Postal Service personnel did not detect discrepancies in these seven appraisals and did not complete checklists, as required, to document the review for six of the seven properties.

Table 2. Disposal Appraisal Discrepancies

Facility Location	Sale Price	Appraised Value	Review Results	Checklist Completed by Postal Service Personnel (Yes/No)
St. Paul, MN	\$5,250,000	\$2,700,000	The market data for this appraisal was insufficient; therefore, the appraiser should consider another approach to value the property. For example, there was no market evidence to support the 75 percent downward adjustment of a comparable sale.	No

¹⁹ The two transactions where CBRE represented the Postal Service and buyer did not contain discrepancies that affected the credibility and reasonableness of the properties’ appraised value.
²⁰ The building had unusual partitioning that was of value for the Postal Service; however, this partitioning would likely be removed by a new user and, therefore, was considered to be a form of functional obsolescence.
²¹ The contractors were different from the contractors who prepared the appraisals.

Facility Location	Sale Price	Appraised Value	Review Results	Checklist Completed by Postal Service Personnel (Yes/No)
Richmond, VA	\$1,454,250	\$1,350,000	The market data for this appraisal was insufficient; therefore, the appraiser should have considered another approach to value the property. For example, a comparable sale was distressed, but no adjustment was made for this condition. The property resold for \$2.4 million within 4 months of sale; however, we do not know the extent of the redevelopment or improvements made by the new owner.	No
Shawnee, OK	\$576,000	\$640,000	The market data for this appraisal, such as comparable properties sold were insufficient; therefore, the Postal Service should have considered another approach to value.	No
West Jersey, NJ	\$5,950,000	\$6,315,000	The appraisal contained mistakes in applying deductions to the market value. For example, the appraiser applied a deduction for functional obsolescence twice.	Yes
Gilbert, AZ	\$2,975,000	\$2,750,000	The appraiser's approach was flawed due to overgenerous estimates of expenses based on market data and very conservative in determining value per square foot of the property as compared to similar properties sold. The new owner redeveloped and leased the building and subsequently sold the property about 1 year later for \$6.8 million. However, we do not know the extent of the redevelopment or improvements made by the new owner.	No
York, PA	\$350,000	\$320,000	The appraisal's estimate of market value was speculative and not well-supported because the appraiser did not perform an analysis of financial feasibility as required.	No
Forest City, NC	\$225,000	\$210,000	The appraisal did not include sufficient evidence or analyses to support the significant adjustments made to comparable land sales or the estimate of market value. For example, the value of a comparable sale was adjusted downward by 115 percent.	No

Sources: Postal Service real estate disposal records and OIG analysis.

In May 2013, the Postal Service changed the process and now obtains the appraisals for properties that CBRE markets.

According to Postal Service policy,²² after personnel read and examine the appraisal report for compliance with the real estate contract and the appraisal review report, they should complete a checklist. The checklist is not intended to detect technical errors in the appraisal, but the employee responsible for the project uses this checklist as a control to review for compliance with the contract. If the appraisal report does not comply with the contract, the contract appraiser must complete any required corrective action before the report is forwarded for approval.

We also found that employees completing the checklists may not be qualified to identify technical errors in the appraisal. For example, a Postal Service employee completed the appraisal review checklist for a property in West Jersey, NJ, as required, but did not identify incorrect deductions to the market value. Without proper oversight, the Postal Service is at increased risk of inaccuracies in the valuation of marketed properties and may not realize maximum revenue from the property sales.

The Postal Service was also subject to the risk that CBRE could manipulate transaction prices to favor its clients or business partners when managing the appraisal and negotiation processes for properties the Postal Service has sold or leased. However, in May 2013, the Postal Service changed the process and now obtains the appraisals for properties that CBRE markets. Therefore, we are not making a recommendation regarding the appraisal process.

Property Sales Records

The Postal Service did not maintain complete and consistent records to support its oversight of real estate property sales. Specifically, employees could not locate a file to support the sale of one property for \$2 million and did not maintain appraisal reviews to support two other sales totaling about \$6.4 million. Also, eight transactions for properties that sold for about \$15.9 million were incorrectly coded in the eFMS and six disposal transactions valued at about \$53,000²³ did not have itemized due diligence costs. Due diligence is a thorough analysis of a property, which can include associated environmental and historical studies, market appraisals, surveys, and reviews.

Disposal Transaction Files

The Postal Service did not maintain key documents to support its oversight of disposal transactions. Specifically, employees could not locate one file to support a \$2 million disposal transaction and did not maintain appraisal reviews to support two other disposal transactions of \$6.2 million and \$235,000. This occurred because Postal Service officials have not revised the procedures for recording and supporting real estate transactions to include activities performed under the CBRE contract. Instead, they relied on the institutional knowledge of the real estate asset managers and specialists as the framework for internal controls over disposal transactions. It is critical that the Postal Service document and communicate its disposal transaction processes to ensure knowledge can be transferred to new or reassigned personnel.

We consider the \$8,405,000 from the proceeds of the three disposal transactions as data integrity errors²⁴ due to the missing disposal documentation. This amount does not represent actual losses the Postal Service incurred but rather incorrect data recorded in the eFMS. See [Table 3](#) for a summary of disposal recordkeeping discrepancies.

²² *Implementing the RE-1 in Postal Real Estate Actions*, revised December 2010, Section 4.5.1, Checklist for Compliance.

²³ Total due diligence costs for the 21 sampled transactions was \$311,000.

²⁴ Data integrity is the validation of the consistency, accuracy, and completeness of data used by the Postal Service uses. Data Integrity errors occur when data used to support management decisions are not fully supported or completely accurate. This can be the result of flawed methodology; procedural errors; or missing or unsupported facts, assumptions, or conclusions.

eFMS listed eight facilities that sold for about \$15.9 million as “active” even though the properties had been sold. These properties remained active in the eFMS from 195 to 749 days from the date of sale.

We found potential relationships between the buyer and CBRE in five transactions.

Table 3. Disposal Recordkeeping Discrepancies

Facility Location	Sales Price	File Discrepancy
New Haven, CT	\$ 2,020,000	Disposal file missing
Pasadena, CA	\$ 6,150,000	Appraisal review missing
Three Rivers, MI	\$ 235,000	Appraisal review missing
Total	\$ 8,405,000	

Sources: Postal Service real estate disposal records and OIG analysis.

Electronic Facilities Management System Coding

As of March 2014, the eFMS listed eight facilities that sold for about \$15.9 million as “active” even though the properties had been sold. These properties remained active in the eFMS from 195 to 749 days from the date of sale. Facilities officials did not provide oversight to ensure the properties were correctly coded. Because they did not accurately record or complete disposal data in the eFMS, officials may not have sufficient information or may incur additional time to compile information to make decisions.

Facilities management took corrective action for four of the facilities by updating the facility record to “disposed” in the eFMS as of June 2014. However, as of June 2014, the eFMS showed all of the projects associated with the other four facilities as closed or canceled, but the facilities remained coded as “active.”

We consider \$15,889,000 as a data integrity error due to inaccurate disposal data recorded in the eFMS. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.

Due Diligence Payments

The Postal Service did not completely itemize due diligence costs in the eFMS for six disposal transactions valued at about \$53,000. Specifically it did not explain the scope of work and expenses. This occurred because there is no standard policy that requires due diligence to be itemized. Failure to itemize due diligence supporting documentation weakens controls over expense verification and transparency.

Because the Postal Service did not itemize due diligence costs for transparency, we classified the \$53,162 as a data integrity error. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.

Unreliable and inaccurate data could impact the Postal Service’s ability to effectively support its decisions and to assist officials across multiple areas of operations. Postal Service policy does not provide guidance regarding disposal records management. A standardized documentation policy is necessary to provide controls over expense verification and to ensure transparency and proper oversight of real estate property sales.

Potential Conflicts of Interest

We found potential relationships between the buyer and CBRE in five transactions. Specifically, we found a relationship between the buyer and CBRE for one transaction and a possible relationship in four others. Our analysis showed that four of the five properties were sold at or above their appraised value. The other property was sold for 96 percent of its appraised value. We do

not believe there were any audit issues; however, because of the increased risks from CBRE managing the appraisal process for these property sales, we have referred the transactions to the OIG's Office of Investigations for further review.

Contracting Officer Representative's Responsibilities

Postal Service officials did not fully implement a recommendation from our prior report²⁵ to designate CORs for the CBRE contract and specify their duties to monitor contract performance and approve payments. Between July 1, 2013, when management agreed to implement the prior recommendation, and September 30, 2013, employees not designated as CORs authorized 12 payments for appraisals and reviews, totaling about \$63,000. During this audit, the contracting officer (CO) for the CBRE contract said individuals approving payments did not need to have a COR designation for the CBRE contract because they were already COs for other contracts. We reviewed the adequacy of internal controls over the delegation of contracting authority from the postmaster general to the vice president, Facilities, in a separate audit.²⁶ Based on discussions during that audit, the CO for the CBRE contract agreed that only he and designated CORs should approve payments for the CBRE contract and stated he would ensure compliance with Postal Service policy.

Postal Service policy²⁷ states that only individuals authorized to manage a given contract are the COs in charge of the contract and the CORs are designated to assist with the contract. Because the CO for the contract or a designated COR did not approve payment authorizations, there is an increased risk of poor contract oversight, unauthorized expenditures, and contract changes. As a result, we questioned \$62,734 in payments for appraisals and reviews because officials did not follow a significant internal control procedure.

²⁵ *Contracting of Real Estate Management Services* (Report Number [SM-AR-13-001](#), dated June 12, 2013).

²⁶ *Delegation of Contracting Authority Outside Supply Management* (Report Number [SM-AR-14-007](#), dated August 5, 2014).

²⁷ *Supplying Principles and Practices*, Section 3-5, Appoint Contracting Officer's Representatives (COR), dated September 2013.

Recommendations

We recommend the vice president, Facilities:

1. Terminate and recomplete the current CB Richard Ellis, Inc. (CBRE) real estate management services contract.
 - a. Ensure the new contract prohibits the contractor from collecting commissions from opposing parties when negotiating leases and from representing both the Postal Service and prospective buyers and lessors in Postal Service real estate transactions.
 - b. Until the current contract is recompleted, modify the current contract to prohibit CBRE from collecting commissions from opposing parties when negotiating leases and from representing both the Postal Service and prospective buyers and lessors in Postal Service real estate transactions.
 - c. Notify lessors they are not required to pay commissions for new leases.
2. Implement policy for lease transactions that requires Postal Service employees to capture the lessor's or Postal Service's initial lease rate offer, market rent, rent analysis results, and responsible negotiator, and record it in the electronic Facilities Management System (eFMS).
3. Implement revisions to the appraisal review checklist to detect technical errors in appraisals and instruct and train employees to comply with the requirement to review appraisals independent of CBRE.
4. Establish updated records management retention requirements for employees to retain files to support real estate transactions, including appraisal reviews.
5. Implement Postal Service policy that requires employees to itemize due diligence payments within the eFMS and update the facility record to "disposed" when the facility is sold.
6. Confirm that the contracting officer follows Postal Service policy to require the proper certification of payment authorizations.

Management's Comments

Management disagreed with significant parts of our report, noting management's allowance of CBRE to collect commissions from lessors for lease negotiations. However, management generally agreed with the remaining findings, generally disagreed with recommendation 1, and agreed with recommendations 2, 3, 4, 5, and 6. Management agreed with our monetary benefits but disagreed with the \$38,101,994 in lease payments identified as disbursements at risk for leases negotiated by CBRE.

Management stated they are concerned by the OIG's report of CBRE personnel engaging in unauthorized negotiation practices. Since inception of the CBRE contract, the Postal Service has prohibited such practices. Management further stated that the Postal Service is committed to addressing these concerns and will work with the OIG to take corrective action, if appropriate.

Management believes the CBRE contract does not prohibit CBRE from collecting leasing commissions from lessors, as the Postal Service's representative. In fact, the CBRE contract explicitly states that the contractor can expect to be paid a leasing fee by lessors. Management further stated that lessors, following standard real estate industry practices, can include such

commissions in the rent charged to the Postal Service over the lease term. Management clarified that the statement in the contract that the Postal Service will not pay commissions applies where the lessor refuses to pay the commission to CBRE. This provision does not apply when the lessor includes commission in the lease rent because, in that event, the lessor is paying (not refusing to pay) a commission to CBRE.

Management stated that compensation through commission is the common method that the General Services Administration (GSA), American Red Cross, ExxonMobil and other large real estate portfolio owners use to compensate third-party brokers. Moreover, management stated that the commercial real estate industry expects that lessors will typically pay commission to tenant representatives and will factor that cost into the rent. Management specifically noted an example where the Association of United States Postal Lessors advised its members that “it is common in non-postal commercial leases for tenants’ representatives to receive a part of the lease commissions paid and that lessors under those leases will factor in the cost of lease commissions when setting the rental rates they will accept.”

Management stated they are not aware of any other alternative broker compensation models widely used for handling large real estate portfolios like the Postal Service’s and that the Postal Service does not have sufficient personnel to handle the volume of leases. Management also stated that paying CBRE directly (in lieu of lessors paying CBRE) would cost the Postal Service millions of dollars, whether such payments were traditional commission or flat fees, and there is no industry model to follow to structure such a program.

Management stated that they do not dispute the OIG’s finding that compares the immediately preceding rental rates to the new lease rental rates; however, management believes the comparison cited in the report is flawed because the data shows that 85 percent of CBRE’s negotiated leases were new leases (the category with the highest risk of rent increase), while 72 percent of Postal Service-negotiated leases were renewals (the category with the lowest risk of rent increase). Therefore, CBRE-negotiated lease results, for the most part, are not fairly comparable to Postal Service-negotiated lease results.

Management also stated that the OIG’s finding reflects that the Postal Service is generally assigning CBRE leases with the highest risk for rent increases and is generally assigning Postal Service personnel leases with the lowest risk of rent increases. Management believes a fair comparison would exclude, for example, Postal Service-negotiated leases with fixed renewal terms, CBRE-negotiated leases with imminent expiration dates, and CBRE-negotiated leases where the Postal Service otherwise had impaired bargaining leverage.

Further, management stated that the Postal Service must enter into leases under current market conditions when the lease is negotiated; therefore, to determine the success of the Postal Service’s lease negotiating strategy, the rents that lessors charged the Postal Service under the new leases should be compared to the current market rent paid in the relevant geographic areas. Moreover, management stated that in determining the optimal business arrangement for the Postal Service, the costs of relocating personnel and machinery and the business disruption caused by moving Postal Service operations may outweigh the negative economic consequences of paying an above-market rental rate.

Management stated that they track CBRE-negotiated lease rental rates against the relevant current market rates and noted that rates for 90 percent of the 5,660 of these leases negotiated between January 2013 and March 2015 were at or below market rates. Specifically, management stated that 3,391 of these leases (or 60 percent) were negotiated at market rate and 1,696 of these (or 30 percent) were negotiated below market rate.

Regarding recommendation 1, management disagreed with terminating the contract and prohibiting CBRE from collecting commissions from lessors. Management believes that terminating the contract at this time would be imprudent because the Postal Service lacks sufficient personnel to handle all of the required leasing activity and does not have any alternative means to satisfy its substantial real estate transaction requirements. Further, management believes it uses the industry standard method for compensating CBRE and does not believe it is in the best interests of the Postal Service to notify lessors that they are not required to pay commissions for new leases.

Management stated, however, that they are in the process of engaging an independent consultant to evaluate certain key aspects of the Postal Service's leasing program with CBRE against industry best practices. Once management receives and evaluates the consultant's report, they will take reasonable corrective actions to ensure consistency with the best practices in the industry, to the extent feasible.

Additionally, management agreed with prohibiting dual representation in leasing transactions and stated that they have begun a process to prevent CBRE's representation of both the Postal Service and lessors in leasing transactions. In sales transactions, however, where the Postal Service is the seller, management will continue to permit dual representation on a case-by-case basis.

Management also expects CBRE to present all offers to the Postal Service, which will independently determine which offer is the optimal business deal. On occasions when CBRE represents the prospective purchaser, management stated that it is, nonetheless, in the best interests of the Postal Service to accept an offer from such a purchaser if that offer represents the best business deal. Management further stated that when the Postal Service is the seller, it (not the opposing party) pays CBRE's commission, which is based on the sale price and incentivizes CBRE to negotiate for the highest price.

While management disagrees with the OIG's recommendation to prohibit CBRE from collecting commissions from opposing parties (pending the report of the independent consultant), management agrees that they should take additional steps to further ensure that the Postal Service obtains the optimal business deal in each leasing transaction. Management stated that, in an effort to address the OIG's concerns, the Postal Service is committed to strengthening its processes and procedures. Management will:

- Improve processes for assuring the Postal Service can rely on appraisals it obtains to determine market rents for leases presented by CBRE. This step includes creating a new Postal Service appraisal administrator position, as discussed in response to recommendation 3.
- Continue to require Postal Service employees to independently research and evaluate market rental rates and ensure that the market rate is accurately stated in the negotiation summary section in eFMS, as discussed in response to recommendation 2.
- Continue to take steps to assure the Postal Service's rental rate for each lease reflects the optimal business deal for the Postal Service, under the circumstances.
- Continue to assign sole responsibility and authority to Postal Service employees for determining whether to accept proposed lease terms or to require different lease terms.
- Not later than April 30, 2015, begin negotiations with CBRE to modify the CBRE contract to eliminate that portion of the award fee that may be viewed as overlapping with lessor-paid commissions.

Regarding recommendation 2, by April 30, 2015, management will issue direction to all Postal Service leasing staff and to CBRE requiring them to state in the leasing negotiation summary section in eFMS: initial offers by the Postal Service and the lessor, the market rate, rent analysis results, and the responsible negotiator.

Regarding recommendation 3, management agreed to improve oversight of appraisals. Management stated they will implement steps by April 30, 2015, to ensure the Postal Service evaluates market lease rates and purchase prices independent of CBRE.

Regarding recommendation 4, management stated they have already begun corrective action. Specifically, Facilities retrained its employees on records retention and is modifying eFMS to permit permanent digital document storage, including all appraisal reviews. The target completion date is September 30, 2015.

Regarding recommendation 5, management stated that they trained staff in 2014 on procedures for itemizing due diligence payments in the eFMS and updating the facility record to “dispose” after a facility is sold. Management also stated that they implemented a policy that work orders must specify the scope of work and breakdown of labor (when applicable). In addition, commitments and payments must reference the applicable work order(s). Management stated that they issued a memorandum to reinforce this policy. In addition, to improve eFMS data, Facilities analysts are now reviewing disposals quarterly to ensure that once all projects and terms are completed, they are updated to “disposed.”

Regarding recommendation 6, management stated that they issued a memorandum to staff members on the proper process for certifying payment authorizations. Further, management stated that they issued a memorandum reminding staff that there are only two COs authorized to sign work orders and payments to CBRE.

See [Appendix B](#) for management’s comments, in their entirety.

Evaluation of Management’s Comments

The OIG considers management’s comments partially responsive to recommendations 1 and 2. Management’s comments were responsive to recommendations 3, 4, 5, and 6; and management’s corrective actions for these recommendations should resolve the issues identified in the report.

While management stated that the CBRE contract language sets the expectation that lessors will pay CBRE a fee as the Postal Service’s tenant representative and is consistent with commercial real estate industry standards, CBRE has not been transparent in notifying lessors that they are not required to pay commissions to retain a lease relationship with the Postal Service. As noted previously in this report, Postal Service lessors have notified the OIG that CBRE agents told lessors that a commission fee was required or else CBRE, as the Postal Service’s representative, would find another building and discontinue the lease. Further, lessors allege that CBRE informed them that they would increase the negotiated lease amounts to “recover” commissions. CBRE suggesting to lessors they can increase the lease amounts to cover commissions is not in accordance with the contract. In addition, CBRE is not effectively representing the Postal Service to negotiate the best deal. CBRE has a fiduciary responsibility to act in the best interest of the Postal Service and, ultimately, the American public.

Management stated that companies and agencies, such as the GSA, use compensation through commissions as a method of paying their brokers. The GSA acknowledged that it pays commissions through rent payments and that there is an expectation that landlords factor a commission into the negotiated rental rate; however, GSA officials disagreed with brokers, such as CBRE,

increasing negotiated rental rates to include commissions. In fact, the brokers that GSA uses offer commission rebates, agreeing to rebate a certain percentage of the commission it receives back to the government. GSA officials stated that they use multiple brokerage firms for real estate transactions and selects the broker for each transaction partly based on their commission rebate proposals.

Regarding the OIG's analysis of renegotiated Postal Service leases, market rental rates at the time of lease renegotiation is a factor considered when determining the effectiveness of negotiated lease rates; however, the Postal Service did not maintain this information for all leases in their systems. As noted in the report, the Postal Service's eFMS did not always capture complete and accurate information and the Postal Service often relies on CBRE's system for information, such as market rate, initial lease rate offer, and result of lease negotiations. All of these elements should be captured in Postal Service systems to effectively evaluate lease transactions and adequately oversee the contractor.

Further, we believe it is prudent to compare CBRE's negotiated lease rate to the rates for leases the Postal Service has negotiated to assess how aggressively CBRE negotiates for the Postal Service. Our analysis considered all leases to show the Postal Service's potential risk when CBRE negotiates leases. CBRE's average lease rate increase of more than three times the Postal Service's average increase is information that management should scrutinize, especially in light of allegations that CBRE is increasing Postal Service lease rates to include its commissions.

Management provided an analysis of 5,660 leases CBRE negotiated between January 2013 and March 2015 and found that 10 percent of the leases were above market rates, 60 percent were at market rates, and 30 percent were below market rates. According to the CBRE contract, "it is Postal Service policy to pay equal to or less than fair market rate for lease spaces"; therefore, the market rate is the most the Postal Service should pay for a lease. Given this information, 70 percent of CBRE-negotiated Postal Service leases were at or over the maximum amount the Postal Service should pay for these, providing additional evidence that CBRE may not be providing the best deal for the Postal Service.

Regarding recommendation 1, we recognize management's partial efforts to address the issues cited in our report. Eliminating dual representation in lease transactions and creating an appraisal administrator position to manage the appraisal and market evaluation process will provide management with increased oversight into its real estate transactions. However, management should also eliminate dual representation in sales transactions. Further, allowing CBRE to charge lessors' commissions continues to be a conflict of interest because CBRE earns revenue from lessors and not the Postal Service. As stated earlier, CBRE may be unduly motivated to increase its commission revenue by conducting lease negotiations that are not in the Postal Service's best interest.

We continue to believe the current contract should be terminated. We are not advocating, as management indicated in their response, using Postal Service personnel to perform the current functions of CBRE. The Postal Service can determine whether the current contractor, Postal Service personnel, or another contractor (or group of contractors – using GSA's model) would be appropriate. Whether under a new contract or staffed by Postal Service personnel, the idea of terminating the current contract is to ensure that future lease and sale negotiations are done with the Postal Service's best interest in mind. Since we have received allegations CBRE is "requiring" lessors to pay commissions, we also believe that the Postal Service should notify lessors that they are expected, but not required, to pay commissions to CBRE.

Regarding recommendation 2, including the responsible negotiator in the negotiation summary text box is inefficient because Facilities personnel will not be able to easily sort this information for management reporting. Instead, management should create a field in eFMS to capture the name of the responsible negotiator.

We intend to take recommendations 1 and 2 through the audit resolution process. We encourage management, as they engage an independent consultant to evaluate the Postal Service's leasing program with CBRE, to evaluate alternative methods of compensation for lease transactions.

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

Appendices

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Appendix A: Additional Information

Background

The Postal Service's real estate objectives are to acquire, lease, build, and expand facilities to support operations. Challenges in the economy, shifts in technology, and other factors have led to a change in the Postal Service's real estate goals and objectives. Currently, the Postal Service's Facilities organization is focused on consolidating and disposing of excess space and vacant properties in an effort to optimize operations, generate revenue, and reduce real estate expenses.

In June 2011, the Postal Service awarded a firm-fixed contract with an award fee²⁸ to CBRE to be its sole provider of real estate management services. Accordingly, CBRE assumed many of the duties Postal Service real estate specialists and other real estate contractors formerly performed. Since the contract was awarded, the Postal Service has paid over \$8 million to CBRE for real estate support. The Postal Service believed that leveraging the capabilities of a national real estate firm would allow for a more effective use of limited resources.

Facilities officials identify properties for disposal through node and area mail processing (AMP) studies. A node study is an operational analysis performed on a plant, retail, or delivery facility and an AMP study is the analysis of the feasibility of relocating mail processing operations from one location to another to improve capacity, efficiency, and service. The studies may reveal a "rightsizing" possibility at an existing facility, the opportunity to sell a vacated owned building, or the potential to terminate an existing leased facility. Facilities officials also consider excess land for disposal. CBRE is not involved in processes that identify properties for sale.

A Postal Service asset manager reviews and accepts offers for properties listed for sale and documents the negotiation process. CBRE negotiates with potential buyers and provides offers to the asset manager, along with advice about whether to accept or reject the offer. When an offer is accepted, the asset manager creates a sales contract that is reviewed by Postal Service legal personnel. The Real Estate Assets manager can approve sales of up to \$10 million; and the vice president, Facilities, can approve sales of over \$10 million. When the sale is completed, the manager sends a disposal to Postal Service Accounting to record the sale. The Postal Service pays CBRE a commission for assisting with the sale of the property.

For leases, officials identify those that are due to expire in 18 months. For leases with annual rates of over \$25,000 per year,²⁹ CBRE engages local brokers to gather market rate data for current comparable space. CBRE presents the findings to Facilities employees. If CBRE finds the current lease rate is above the market rate,³⁰ it negotiates the lease terms with the lessor and notifies Facilities personnel of the proposed lease terms. Once approved, the lease is executed. CBRE also negotiates the majority of all new Postal Service leases. CBRE is allowed to collect commissions from lessors in addition to payments from the Postal Service based on performance targets for lease renewals.

Objective, Scope, and Methodology

Our objective is to assess the Postal Service's internal controls over real estate CBRE-marketed property sales and lease negotiations. We also followed up on a prior recommendation to designate CORs to monitor CBRE's contract performance and approve payments. Our audit scope covered the period January 2012 to September 2016. To accomplish our objective we:

²⁸ Based on its performance, CBRE is eligible to receive award fee payments.

²⁹ Lease renewals with annual rates of \$25,000 or less are negotiated by Facilities personnel.

³⁰ If CBRE finds the current lease rate is equal to or lower than the market rate, the lease is negotiated by Facilities personnel.

- Identified a universe of 83 properties the Postal Service disposed of between January 2012 and September 2013. Forty-eight of the property sales were marketed by CBRE. Of the 48 property sales, we judgmentally selected a sample of 21 based on a comparison of the property's sale price to the appraised value, book value, assessed value and the broker's opinion of value. We also reviewed property sales that involved dual agency representation where CBRE represented the Postal Service and prospective buyers.
- Reviewed the disposal justifications, records of offers and CBRE negotiations, due diligence costs, and related documentation for the 21 property sales.
- Used a contractor to review appraisals for 20 of the sample property sales³¹ to determine whether the appraisals were reasonable and credible.
- Compared the buyers of our sampled disposal transactions to LexisNexis³² information and obtained information to determine if there were any related party transactions or conflicts of interest that could have negatively impacted the Postal Service.
- Identified a universe of 7,122 lease negotiations completed between January 2012 and September 2013 (CBRE negotiated 1,698 of the leases). We randomly selected a sample of 30 leases and reviewed documentation supporting these transactions, including paper files, electronic lease files in eFMS, and CBRE's CBRM.
- Analyzed 15,793 lease renegotiations with a lease renewal date between October 2012 and September 2016.
- Used a contractor to review the lease rates for the eight dual agency leases to determine if the market rates were reasonable.
- Randomly selected another 30 lease transactions and reviewed their supporting documentation.
- Identified all payments made against the CBRE contract during our scope period and reviewed all associated work orders and payment authorizations.
- Interviewed Postal Service employees and discussed our findings with appropriate officials.

We conducted this performance audit from November 2013 through April 2015, 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 on March 30, 2015, and included their comments where appropriate.

To conduct this review, we relied on computer-processed data in the Enterprise Data Warehouse (EDW)³³ and eFMS. We did not test the validity of controls over these systems. However, we determined the accuracy of the data by comparing eFMS records to the reports generated by CBRE and Facilities contract files. Additionally, we compared supplier payment reports from EDW to both

³¹ The file for one disposal was missing.

³² A corporation providing computer-assisted legal research.

³³ A single repository for managing the Postal Service's corporate data assets.

eFMS records and the associated paper files. We determined that the data were sufficiently reliable for the purposes of this report.

Prior Audit Coverage

Report Title	Report Number	Final Report Date	Monetary Impact (in millions)
<i>Preservation and Disposal of Historic Properties</i>	SM-AR-14-004	4/16/2014	None
<p>Report Results: The Postal Service did not know the number of its historic properties or their associated costs and did not report the status of historic artwork to the National Museum of American Art when it sold 10 historic post offices. In addition, it did not collaborate with the Advisory Council on Historic Preservation to improve its compliance with regulations. The Postal Service could also use the U.S. General Services Administration to assist in the preservation process. The vice president, Facilities, approves funding for relocations and also issues the final determination letter after reviewing appeals raised during the process. This gives the appearance of bias. In addition, in three instances the Postal Service did not follow, or could not substantiate that it followed, relocation requirements. Management agreed with all findings and recommendations except the recommendation to enter into a program alternative with the Advisory Council on Historic Preservation.</p>			
<i>Risks Associated with CB Richard Ellis, Inc. Contract</i>	SM-MA-14-003	2/12/2014	None
<p>Report Results: We identified additional information about the CBRE contract that increased financial risks to the Postal Service. Specifically, Postal Service officials modified the contract in June 2012 to allow CBRE to negotiate on its behalf and on behalf of prospective buyers and lessors in the same real estate transaction. Management disagreed with our recommendation to discontinue the practice.</p>			
<i>Contracting of Real Estate Management Services</i>	SM-AR-13-001	6/12/2013	\$1.7
<p>Report Results: Postal Service Facilities officials should improve oversight of the CBRE contract. Specifically, there were conflict of interest concerns and no maximum contract value. In addition, the CO did not properly approve contract payments, appoint CORs to monitor contract performance, or ensure services were provided. Management agreed with our recommendations to establish a reasonable maximum contract value and designate CORs.</p>			

Appendix B: Management's Comments

TOM A. SAMRA
VICE PRESIDENT, FACILITIES



April 2, 2015

LORI LAU DILLARD via email (audittracking@uspsoig.gov)
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Draft Audit Report – Postal Service Management of CBRE Real Estate Transactions.
Draft Audit Report Number SM-AR-14-DRAFT (March 16, 2015)

Thank you for the opportunity to review and comment on the above referenced revised draft Audit Report. The Postal Service generally agrees with the Report's findings and will adopt nearly all of the OIG's recommendations.

In Section A below, Management addresses the OIG's findings. In Section B below, Management addresses the OIG's recommendations. In Section C, Management responds to the OIG's Report of Monetary and Other Impacts.

A. OIG Draft Audit Report Findings and Management Response.

OIG Finding #1.

Lessors in the past often negotiated leases directly with the Postal Service without representation. However, since the start of the CBRE contract, some lessors have told the OIG of having been approached by CBRE agents regarding required payment of a commission to CBRE. In these instances, the lessors expressed that they were told if they did not agree to pay CBRE a commission, CBRE, as the Postal Service's representative, would find another building and discontinue the lease. We also received allegations that CBRE announced, rather than negotiated, the lease rate the Postal Service would pay. CBRE informed lessors that they could "recover" these fees from the Postal Service's increased rents. CBRE made the process for commissions appear mandatory despite the fact that the Postal Service had no such requirement. This arrangement allowed CBRE to negotiate in its own best interest by, in essence, representing both the lessor and the Postal Service.

These practices increase the Postal Service's financial risk as lessors will consider commission fees a cost of doing business with the Postal Service and, thereby, increase rental rates to include these fees. Prior to the CBRE contract, lessors negotiated directly with the Postal Service regarding lease terms and did not have to pay commission fees. The Postal Service's contract with CBRE states the Postal Service will not pay commissions for negotiating leases; however, Postal Service management allowed CBRE to include commissions in the lease rent that the Postal Service paid because the total lease amount, with commissions, was within the market rent valuation. Management stated it was an industry standard to include commissions in market rent. We did not identify evidence to substantiate this claim.

We analyzed 15,793 renegotiated Postal Service leases with renewal dates falling between October 2012 and September 2016. CBRE collected commissions on 3,405 of 4,718 leases it renegotiated, with commissions totaling \$20.6 million. Of the 4,718 leases CBRE negotiated, the average annual rent increase was \$2,792 (8.07 percent) more than the prior lease rate. The Postal Service's average rent increase was \$773 (3.53 percent) for the 11,075 leases it renegotiated. CBRE's average lease rate increase was more than three times higher than the Postal Service's increase. As a result, the Postal Service could be overpaying an estimated \$9.5

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million annually for leases CBRE negotiated. We questioned \$38,101,994 in lease payments the Postal Service is making for FYs 2013 to 2016 by having CBRE negotiate its leases. We also identified 57 leases where CBRE negotiated a rate increase of 200 percent or more than the previous lease rate. Because the percentage increases were significantly higher than CBRE's average lease rate increase of 8.07 percent, we have referred these transactions to the OIG's Office of Investigations for further review.

Management Response to Finding #1:

Management is concerned by the OIG's report of CBRE personnel engaging in unauthorized negotiation practices. Since inception of performance of the CBRE contract, the Postal Service has prohibited such practices. The Postal Service is committed to addressing these concerns and will work with the OIG to take corrective action, if appropriate.

Management believes that the CBRE contract does not prohibit CBRE from collecting a leasing commission from landlords as the Postal Service's representative; in fact, the CBRE contract explicitly states that the contractor can expect to get paid a leasing fee from landlords. This is in accordance with standard practices in the real estate leasing industry. Moreover, the statement in the CBRE contract that the Postal Service will not pay commissions applies, as made explicit in the language of the contract, where the landlord refuses to pay the commission to CBRE. The contract does not prohibit CBRE from collecting leasing commissions from landlords. Landlords, following standard practices in the real estate industry, can include such commissions in the rent charged to the Postal Service over the lease term. The contract states:

The USPS intends to issue leasing assignments... for which the contractor can expect to get paid a leasing fee from the Landlord, as the tenant's representative in the transaction... The USPS will NOT be responsible for the payment of leasing commission, brokerage fees, or any other payment to any party *should the landlord refuse to pay the contractor's tenant representative leasing commission (emphasis added)*.

The first sentence of this contractual provision sets forth the parties' expectation that landlords will pay CBRE a fee as the Postal Service's tenant representative. The second sentence clarifies that if the landlord refuses to pay a commission, then CBRE cannot look to the Postal Service for payment of the commission. That second sentence does not apply when the landlord includes commission in the lease rent because in that event the landlord is paying (not refusing to pay) a commission to CBRE. Moreover, for the reasons discussed in Management Response to Recommendation # 1, the Postal Service expected that landlords would include commissions in the Postal Service's rent in accordance with standard industry practice.

Management does not dispute the factual result of the OIG's finding that compares the immediately preceding rental rates versus the new lease rental rates. However, Management believes the comparison cited in the draft report is flawed because the data shows that 85% of the CBRE negotiated leases were new leases (the category with the highest risk of rent increase), while 72% of the Postal Service negotiated leases were renewals (the category with the lowest risk of rent increase). Therefore, the CBRE negotiated lease results, for the most part, are not fairly comparable to the USPS negotiated lease results. At the time the Postal Service entered into the CBRE contract, the Postal Service needed to achieve lease cost savings, but given the limited number of Postal Service personnel, the Postal Service needed to leverage the resources of a large national real estate company to accomplish these savings. To make the best use of Postal personnel and their finite time, the Postal Service generally has assigned to CBRE all large lease renewals and all new leases, which are the leases that require the most time to negotiate. They are also the leases with the highest risk of rent increase. The Postal Service generally has assigned to Postal personnel, who now have the additional sizable task of managing CBRE workflow, small lease renewals with fixed renewal terms, which require the least time to negotiate, and have the lowest risk of rent increase. However, when any of those smaller

leases have had above market renewal rent, the Postal Service generally has assigned those leases to CBRE to attempt to negotiate a lower rate. Therefore, Management believes the OIG's finding reflects the Postal Service generally assigning to CBRE the leases with the highest risk for rent increases and generally assigning to Postal personnel the leases with the lowest risk of rent increases. Management believes a fair comparison would exclude, for example, USPS negotiated leases with fixed renewal terms, CBRE negotiated leases with imminent expiration dates, and CBRE negotiated leases where the USPS otherwise had impaired bargaining leverage.

Further, Management believes, as a business matter, that the comparison most likely to reflect whether the Postal Service real estate program is commercially reasonable is a comparison of new rental rates versus market rental rates. Since the Postal Service must enter into leases under the then current market conditions, the rents being charged by landlords to the Postal Service under the new leases as compared to the current market rents being paid in the relevant geographic area should be evaluated to determine the success of the Postal Service's lease negotiation strategy. Moreover, in determining the optimal business arrangement for the Postal Service, the costs of relocating personnel and machinery and the business disruption caused by moving the postal operation may outweigh the negative economic consequences of paying an above market rental rate. For those reasons, a comparison of what the Postal Service pays on a going forward basis against the historic rental rate is unlikely to provide meaningful information. Instead, USPS tracks CBRE-negotiated lease rental rates against the relevant current market rates. As demonstrated by the following chart, since January 2013, CBRE-negotiated lease rates are at or below market rates for 90% of our leases:

**CBRE Lease Negotiation
 Cumulative January 2013 through March 2015**

	Below Market	At Market	Above Market	Totals
No. of Leases	1696	3391	573	5660
Percent of Total Leases	30%	60%	10%	100%

OIG Finding #2:

The Postal Service did not accurately identify CBRE as the lease negotiator in the electronic Facilities Management System (eFMS) for 1,049 of 4,718 leases, with annual rents totaling about \$59 million. Tracking leases that CBRE negotiates is essential for properly managing these transactions. Twenty-six of 30 randomly selected lease negotiations that we reviewed, totaling about \$4.7 million in annual rent, did not have supporting documentation to capture the proposed lease rate for review against the final negotiated rate. The Postal Service did not require CBRE to record initial offers, which are necessary to ensure the transparency and reasonableness of the negotiated lease amounts. Additionally, documentation for market rent rates and analyses for all 30 were not centrally maintained in eFMS.

Management Response to Finding #2:

Management agrees that identifying the lease negotiator and capturing the lease negotiation history, market rent, and rent analysis has value. As noted below in the response to OIG Recommendation #5, by April 30, 2015, Management will issue direction to all USPS Leasing staff and to CBRE requiring them to include in the eFMS leasing negotiation summary the responsible negotiator, initial offers by both USPS and the Landlord, the market rate, and rent analysis results.

OIG Finding #3.

Postal Service employees did not itemize the detailed expenses CBRE invoiced in eFMS for 111 of 246 payments made to CBRE for later analysis. The 111 payments totaled about \$466,000. Itemization is needed to enable management review.

Management Response to Finding #3:

Management agrees with this finding; however, the Postal Service has ceased using CBRE to perform the type of work for which these 111 payments were made.

OIG Finding #4.

For the 21 property sales transactions reviewed, the Postal Service met its sales goal of 90 percent or more of the properties' appraised value; however, CBRE managed the entire appraisal process. The appraisals were solicited by CBRE, prepared by contractors, and used to determine whether the sale price was acceptable to the Postal Service. To avoid conflicts of interest, the appraisal process is normally managed and performed by professionals not involved in negotiating sales and leases or by realtors marketing the properties. We concluded that appraisals for seven of the transactions contained questionable financial analyses and comparisons to other properties that could have affected the credibility and reasonableness of the estimated market value. We did not calculate a revised appraised value for the seven properties due to the time lapse since the original appraisal and the cost to do a full appraisal. Instead, we focused on the adequacy of the appraisal methodologies. Postal Service personnel did not detect discrepancies in these seven appraisals and did not complete checklists, as required, to document the review for six of the seven properties. Instead, they relied on contractors hired to review the appraisal to complete the checklists.

Management Response to Finding #4:

Although Management believes that the Postal Service obtained fair market value for the properties associated with this finding, Management nevertheless agrees that it is important for the Postal Service to have confidence that all of the appraisals upon which we rely to determine the proper market rate are properly prepared and technically proficient. As discussed in our response to Recommendation #1, the Postal Service is taking steps to improve the appraisal process.

OIG Finding #5.

Employees could not locate a file to support the sale of one property for \$2 million and did not maintain appraisal reviews to support the sale of two properties totaling about \$6.4 million.

Management Response to Finding #5:

Management agrees that disposition files and appraisal checklists must be adequately maintained and stored, and will take steps to avoid this kind of error in the future.

OIG Finding #6.

Eight properties that sold for about \$15.9 million were incorrectly coded as "active" (not sold) in the facilities management system and six disposal transactions valued at \$53,000 did not have itemized due diligence costs.

Management Response to Finding #6:

Management has undertaken steps to ensure that eFMS is updated on a timely basis, and is changing its policy to require itemization of all due diligence costs when applicable.

OIG Finding #7:

We found potential relationships between the buyer and CBRE in five transactions. Specifically, we found a relationship between the buyer and CBRE for one transaction and a possible relationship in four others. Our analysis showed that four of the five properties were sold at or above their appraised value. The other property was sold for 96 percent of its appraised value. We do not believe there were any audit issues; however, because of the increased risks from CBRE managing the appraisal process for these property sales, we have referred the transactions to the OIG's Office of Investigations for further review.

Management Response to Finding #7:

Given the referral of this matter to the Office of Investigations, Management will not comment on this recommendation.

OIG Finding #8:

Management did not fully implement a prior OIG recommendation to designate CORs to monitor contract performance and approve payments to CBRE. Between July 1, 2013, when management agreed to implement the prior recommendation, and September 30, 2013, employees not designated as CORs authorized 12 payments, totaling about \$63,000. Because payment authorizations were not approved by the CO for the contract or a designated COR, there is an increased risk of poor contract oversight, unauthorized expenditures, and contract changes.

Management Response to Finding #8:

Management agrees that this recommendation was not fully implemented until October 2013, when the Postal Service reiterated that only a single contracting officer is allowed to authorize or approve payments under the CBRE contract. Management acknowledges that during a short period, between July and October, 2013, other contracting officers, rather than the CO on the particular contract, signed work orders to close out remaining due diligence payments. Management has corrected this matter. CORs have been appointed.

B. OIG Draft Audit Report Recommendations and Management Response.

OIG Recommendation #1:

Terminate and re-compete the current CB Richard Ellis, Inc. (CBRE) real estate management services contract.

- Ensure the new contract prohibits the contractor from collecting commissions from opposing parties when negotiating leases and from representing both the Postal Service and prospective buyers and lessors in Postal Service real estate transactions.
- Until the current contract is re-competed, modify the current contract to prohibit CBRE from collecting commissions from opposing parties when negotiating leases and from representing both the Postal Service and prospective buyers and lessors in Postal Service real estate transactions.
- Notify lessors they are not required to pay commissions for new leases.

Management Response to Recommendation #1:

As discussed below, Management agrees in part, and disagrees in part with this recommendation, pending Management's receipt and review of a consultant's report evaluating certain key aspects of the Postal Service's leasing program with CBRE against industry best practices.

As an initial matter, Management is in the process of engaging an independent consultant to evaluate certain key aspects of the Postal Service's leasing program with CBRE against industry best practices. Once Management receives and evaluates that report, Management will take reasonable corrective actions to insure consistency with the best practices in the industry, to the extent feasible. Pending Management's receipt and evaluation of that consultant's report, Management disagrees in the interim with the recommendation to terminate and re-compete the CBRE contract. Management believes that terminating the contract at this time would be imprudent because the Postal Service lacks sufficient personnel to handle all of the required leasing activity and because the Postal Service does not have any alternative means to satisfy the Postal Service's substantial real estate transaction requirements. Further, because Management believes it uses the industry standard method for compensating its broker and because Management will implement the additional actions identified above, Management also believes termination of the CBRE contract is inadvisable at this time.

For the same reasons, Management does not believe it is in the best interests of the Postal Service to notify lessors they are not required to pay commissions for new leases. However, Management will re-evaluate this position after reviewing the report of the consultant described above.

Management agrees with the recommendation with respect to dual representation in leasing transactions. Management has begun a process to prevent CBRE's representation of both the Postal Service and lessors in leasing transactions.

In sales transactions, however, where the Postal Service is the seller, Management will continue to permit dual agency on a case by case basis. The Postal Service expects CBRE to present all offers to the Postal Service, and then the Postal Service independently determines which is the optimal business deal for the Postal Service. On those occasions when CBRE represents the prospective purchaser, it is nonetheless in the best interests of the Postal Service to accept an offer from such a purchaser if that offer represents the best business deal for the Postal Service, including situations when it is the highest offer to the Postal Service. Further, when the Postal Service is the seller, the Postal Service (not the opposing party) pays CBRE's commission, and the commission, based on the sales price, incentivizes CBRE to negotiate for the highest price to the Postal Service.

Concerning CBRE's collecting commissions from Postal Service landlords, as noted above, the Postal Service believes it uses the industry standard method for compensating its broker. Compensation through commissions is the common method used by the General Services Administration, American Red Cross, ExxonMobil and other large real estate portfolio owners for compensating third party brokers (see Schedule 1 for other examples). Moreover, the commercial real estate industry expects that lessors will typically pay commissions to tenant representatives and then factor that cost into the rent. For example, with respect specifically to Postal Service lessors paying CBRE a commission, the Association of United States Postal Lessors (AUSPL) advises its members, "it is common in non-postal commercial leases for tenants' representatives to receive a part of the lease commissions paid... [and] the lessors under those leases factor in the cost of lease commissions when setting the rental rates they will accept." Management is not aware of any other alternative broker compensation models widely used for handling large real estate portfolios like that of the USPS. The Postal Service does not have sufficient personnel to handle the volume of leasing today. Paying CBRE directly (in lieu of lessors paying CBRE) would cost the Postal Service millions of dollars, whether such payments were on a traditional

commission or flat fee basis, and there is no industry model to follow to structure such a program. Further, as noted above in Management's response to OIG's Finding #1, on an overall basis, CBRE consistently has delivered most leases with at or below market lease rates for the Postal Service. However, as noted above, Management will re-evaluate this position after reviewing the consultant's report evaluating certain key aspects of the Postal Service's leasing program with CBRE against industry best practices.

While Management disagrees with the OIG's recommendation to prohibit CBRE from collecting commissions from opposing parties pending the report of the consultant, Management agrees that additional steps should be taken to further ensure that we obtain the optimal business deal for the Postal Service in each leasing transaction under the circumstances. Management agrees that the Postal Service must have a robust process in place to make its own, independent determination that we are obtaining the optimal deal for the Postal Service in every lease transaction under the circumstances. In an effort to address the OIG's concerns in that regard, the Postal Service is committed to strengthening our processes and procedures to ensure that we can independently determine that our lease transactions represent the optimal business arrangement for the Postal Service, given its unique role and requirements. In that regard, Management will:

- Improve our processes for assuring the Postal Service can rely on appraisals it obtains to determine market rents for leases presented by CBRE. This step includes creating a new USPS Appraisal Administrator position as discussed below in response to Recommendation #3.
- Continue to require Postal Service employees to independently research and evaluate market rental rates, and ensure that the market rate is accurately stated in the negotiation summary in eFMS, as discussed below in Management Response #2.
- Continue to take steps to assure the Postal Service's rental rate for each lease reflects the optimal business deal for the Postal Service under the circumstances.
- Continue to assign sole responsibility and authority to Postal Service employees for determining whether to accept proposed lease terms or to require different lease terms.
- Not later than April 30, 2015, begin negotiations with CBRE to modify the CBRE contract to eliminate that portion of Award Fee that may be viewed as overlapping with lessor paid commissions.

OIG Recommendation #2.

Implement policy for lease transactions that requires Postal Service employees to capture the lessor's or Postal Service's initial lease rate offer, market rent, rent analysis results, and responsible negotiator, and record it in the enterprise Facilities Management System (eFMS).

Management Response to Recommendation #2:

Management agrees with this recommendation. By April 30, 2015, Management will issue direction to all USPS Leasing staff and to CBRE requiring them to state in the leasing negotiation summary in eFMS the initial offers by both USPS and the Landlord, and the market rate, rent analysis results, and responsible negotiator.

OIG Recommendation #3.

Implement revisions to the appraisal review checklist to detect technical errors in appraisals and instruct and train employees to comply with the requirement to review appraisals independent of CBRE.

Management Response to Recommendation #3:

Management agrees with the recommendation to improve oversight of appraisals. Management has implemented, or will implement by April 30, 2015, the following steps to assure the Postal Service evaluates market lease rates and purchase prices independent of CBRE:

- Train employees to ensure all appraisal procedures, including checklists, are completed.
- Create and fill a new USPS Appraisal Administrator position to:
 - Manage appraisal activities, highlight risk management concerns, and ensure Postal Service procedures comply with regulatory requirements, professional standards and Postal policy.
 - Ensure robust reporting of property valuations and supporting rationales.
 - Implement and maintain quality controls
 - Oversee on-going training for quality and control and implement additional training of Postal Service employees to increase their proficiency in independently determining market rents and prices and evaluating offers presented by CBRE.
 - Evaluate and implement improvements to existing Postal Service appraisal procurement and evaluation procedures.
- Review current forms used by the Postal Service in the appraisal process, including the appraisal checklist, for adequacy and consistency.
- Improve accountability by requiring three levels of sign-offs for an appraisal: by the review appraiser, by the Postal Service employee handling the lease or sale transaction, and by the Appraisal Administrator.
- When USPS procures an appraisal, and then engages a second appraiser to review that appraisal, USPS will require the second appraiser to confirm the soundness of the appraisal's value determination.

OIG Recommendation #4.

Establish updated records management retention requirements for employees to retain files to support real estate transactions, including appraisal reviews.

Management Response to Recommendation #4:

Management agrees with the recommendation and has already begun implementation of procedures to address this recommendation. Facilities re-trained employees prior to October 31, 2014, regarding records retention. Due to funding approval delays, we could not implement further changes to eFMS with respect to record retention. Funding was approved on January 30, 2015, and Management has now begun the process of modifying eFMS to permit permanent digital storage of additional documents (including all appraisal reviews) in eFMS and on-line access to the documents by permitted users. Management expects this modification will be in place by September 30, 2015.

OIG Recommendation #5.

Implement Postal Service policy that requires employees to itemize due diligence payments within eFMS and update the facility record to "disposed" when the facility is sold.

Management Response to Recommendation #5:

Management agrees with this recommendation and has already begun implementation of procedures to address this recommendation. Prior to October 31, 2014, staff was trained on the procedures to itemize due diligence payments within the enterprise Facilities Management System and update the facility record to "disposed" when the facility is sold. Management will issue a clarifying memorandum to all Facilities staff to reiterate the importance of itemizing due diligence commitments and payments within eFMS. Management implemented a policy in 2014 whereby work orders must specify the scope of work and breakdown of labor (when applicable) and commitments and payments must reference the work order(s) covered by the applicable commitment and/or payment. Management has reinforced this policy by a written memorandum to the Facilities staff issued by March 6, 2015. Also, to improve eFMS data, disposals will be reviewed on a quarterly basis by the Facilities Analyst to ensure, once all projects and terms are completed, projects are updated to "disposed." This quarterly review process has been implemented beginning on April 1, 2015.

OIG Recommendation #6.

Confirm that the contracting officer follows policy to require the proper certification of payment authorizations.

Management Response to Recommendation #6:

Management agrees with this recommendation and has already begun implementation of procedures to address it. Management issued a memorandum to the staff in September 2014, regarding the proper certification of payment authorizations. Management issued a memorandum on March 6, 2015, reminding staff that there are currently only two contracting officers authorized to sign work orders and payments to CBRE and no other individuals are authorized or permitted to contract or pay for work via the CBRE contract.

C. OIG Reported Monetary and Other Impacts, and Management's Response.

OIG Reported Monetary Impacts.

OIG reported \$62,734 as Unsupported Questioned Costs, attributed to the payments discussed above in OIG Finding #8.

OIG Reported Other Impacts

Disbursements at Risk

1. OIG reported \$38,101,994 as Disbursements at Risk, attributed to the difference between CBRE and USPS negotiated leases when comparing the immediately preceding rental rates versus the new lease rental rates over a four year period.

Data Integrity

2. OIG reported \$59,226, 012 as the value of the Postal Service not properly identifying the lease negotiator in 1,049 leases. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.
3. OIG reported \$4,677,662 as the value of the Postal Service omitting lease negotiation information for 30 lease transactions. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.
4. OIG reported \$465,941 as the value of the Postal Service missing due diligence itemization for 111 lease transactions. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.
5. OIG reported \$8,405,000 as the value of the Postal Service not locating a missing file or two appraisal reviews. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.
6. OIG reported \$15,889,000 as the value of the Postal Service not changing its database from "active" to "sold" for eight properties. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.
7. OIG reported \$53,162 as the value of the Postal Service not having due diligence itemization for six disposal transactions. This amount does not represent actual losses incurred by the Postal Service but rather incorrect data recorded in the eFMS.

Management Response to OIG Monetary and Other Impacts:

Management Response to Monetary Impacts - As discussed in Management Response to Finding #8, Management has corrected the matter.

Management Response to Other Impact #1- Disbursements at Risk – Management disagrees with the characterization of this amount as Disbursements at Risk. Management followed the terms and conditions of the CBRE contract and the internal processes in that all rents whether negotiated by CBRE or by the Postal Service were reviewed and determined to be acceptable based upon our internal controls and rent analyses. Moreover, the amount listed is misleading because the analysis used to obtain it is flawed. The two data sets used for the most part are not fairly comparable. CBRE negotiated leases where there was no fixed renewal rent, or the fixed renewal rent was above market and thus generally unacceptable to the Postal Service. Thus, CBRE had to negotiate based upon current market conditions. In contrast, the Postal Service generally handled renewals where the rent was established years ago and acceptable to the Postal Service, thus eliminating the need for substantial negotiations. Further Management believes comparing the new lease rate versus the prior lease rate is unlikely to provide meaningful information. Instead, USPS tracks CBRE-negotiated lease rental rates against the relevant current market rates, and, as demonstrated in the chart above, since January 2013, CBRE-negotiated lease rates are at or below market rates for 90% of our leases.

Management Response to Other Impacts #2 and #3 - Data Integrity - Management agrees that the amounts OIG identified do not represent actual losses incurred by the Postal Service, but rather incorrect data recorded in the eFMS. As discussed in Management Response to

April 2, 2015
Ms. Lori Lau Dillard
USPS Management Response to Draft Audit Report Number SM-AR-14-DRAFT (March 16, 2015)
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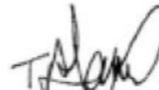
Finding #2, Management will require identification of the responsible negotiator and lease negotiation information in the future.

Management Response to Other Impact #4 - Data Integrity - Management agrees that the amount OIG identified does not represent an actual loss incurred by the Postal Service, but rather incorrect data recorded in the eFMS. As discussed in Management Response to Finding #5, the Postal Service has ceased using CBRE to perform the type of work for which these 111 payments were made.

Management Response to Other Impact #5 - Data Integrity - Management agrees that the amount OIG identified does not represent an actual loss incurred by the Postal Service, but rather incorrect data recorded in the eFMS. As discussed in Management Response to Finding #5, Management will take steps to avoid this kind of error in the future.

Management Response to Other Impacts #6 and #7 Data Integrity - Management agrees that the amounts OIG identified do not represent actual losses incurred by the Postal Service, but rather incorrect data recorded in the eFMS. As discussed in Management Response to Finding #6, Management has undertaken steps to ensure that eFMS is updated on a timely basis, and is changing its policy to require itemization of all due diligence costs when applicable.

In conclusion, Management appreciates the OIG's efforts in auditing the Postal Service's Management of CBRE Real Estate Transactions and preparing this draft Audit Report. The draft report and Management's responses do not contain information that Management believes may be exempt from disclosure under the FOIA.



Tom Samra

Attachment

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