U.S. House of Representatives
Committee on Transportation and Infrastructure
Washington, DC 20515

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June 10, 2011

BRIEFING MEMORANDUM

TO:	Members of the Subcommittee on Economic Development, Public Buildings, and Emergency Management
FROM:	Subcommittee on Economic Development, Public Buildings, and Emergency Management Staff
SUBJECT:	Oversight Hearing on "The Securities and Exchange Commission's $500 Million Fleecing of America"

PURPOSE

The Subcommittee on Economic Development, Public Buildings and Emergency Management will meet on Thursday, June 16, 2011, at 10:00 a.m. in 2167 Rayburn House Office Building to receive testimony from the U.S. Securities and Exchange Commission (SEC), the SEC Inspector General (SEC IG), and the General Services Administration (GSA). The hearing will focus on the SEC's management of its independent authority to lease space and, in particular, the Subcommittee will examine issues detailed in a May 16, 2011, SEC IG report related to SEC's most recent lease procurement of 900,000 square feet of space under a 10-year lease worth over $500 million. While GSA was not involved in the procurement of SEC's leased space, GSA will provide the Subcommittee with information on the processes and standards it uses to evaluate the need for new space and how it conducts procurements for leased space to assist the Subcommittee in better evaluating SEC's actions.

BACKGROUND

Public Buildings and Leases

The Subcommittee has jurisdiction over all of GSA's real property activity through the Property Act of 1949, the Public Buildings Act of 1959, and the Cooperative Use Act of 1976. These three Acts are now codified as title 40 of the United States Code. The GSA's Public Buildings Service (PBS) is responsible for the construction, repair, maintenance, alteration, and operation of United States courthouses and public buildings of the Federal Government. Additionally, PBS leases privately owned space for Federal use. GSA owns or leases 9,600 assets and maintains an inventory of more than 362 million square feet of workspace. GSA acts as the "landlord" for the federal government, obtaining and managing space to meet the space needs of other federal agencies. GSA, however, is just one of nine[1] federal agencies that, in total, own or manage 93% of federal real property.

While GSA has generally been the "landlord" for the federal government for civilian properties, over time several agencies have obtained their own authority independent of GSA to procure and lease new space. As a result, authority to lease space has proliferated and, in some cases, to agencies that neither have the mission nor expertise to appropriately manage such authority. The SEC is one of those agencies that has been granted this authority.

SEC's Lease of 900,000 Square Feet at Constitution Center

On July 28, 2010, the SEC entered into a sole source lease for 900,000 square feet of space with an option to lease 500,000 additional square feet at Constitution Center located at 7th and D Streets, SW, in Washington, D.C. (A timeline related to the leasing of Constitution Center is attached). The SEC's rationale for the need for new space related to passage of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) which expanded SEC's responsibilities. The $556 million lease was "negotiated" in three business days and signed on July 28, 2010 and not long after it was signed questions were raised regarding whether the SEC needed the space. The building is owned by David Nassif Associates (Landlord) and is the former location of the Department of Transportation headquarters. The building was completely renovated by the Landlord to be a modern, efficient class A office building, reportedly exceeding Level IV security standards and is expected to be rated LEED Gold, a top green building certification. Following reports of the lease agreement, the SEC IG initiated an investigation into the lease. On May 16, 2011, the SEC IG concluded its investigation and, at the request of the Subcommittee, the SEC released the report to the Subcommittee.

Findings and Recommendations of the Inspector General

In the report, the SEC IG concluded: "[w]e found that OAS [Office of Administrative Services at SEC] grossly overestimated the amount of space needed at SEC Headquarters for the SEC's projected expansion by more than 300 percent and used these groundless and unsupportable figures to justify the SEC committing an expenditure of $556,811,589 over 10 years."[2] In fact, in the course of the SEC IG's investigation, one

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[1] The other major land-holding departments and agencies include the Department of Defense, Veterans Affairs, Department of Energy, Department of Homeland Security, Department of the Interior, Department of State, National Aeronautics and Space Administration, and the U.S. Postal Service.

[2] *Improper Actions Relating to the Leasing of Office Space, Report of Investigation,* Office of the Inspector General, U.S. Securities and Exchange Commission, May 16, 2011 (OIG-553), p. 2.

SEC Realty Specialist described the standard used to develop the needed space figures "as a 'WAG' (wild-ass guess) and a 'back of the envelope' calculation."[3]

After the SEC recognized that it may not have needed the leased space, the Landlord worked with SEC to allow other federal agencies to assume portions of the lease. Since then, the Office of the Comptroller of the Currency (OCC) and the Federal Housing Finance Agency (FHFA) entered into leasing agreements for space at Constitution Center, leaving approximately 350,000 square feet remaining on SEC's lease. The Landlord, however, has claimed that SEC's actions have caused it to incur damages totaling more than $93 million.[4]

Key Findings of the Inspector General

- **Inflated Staffing Numbers:** SEC inflated the projected numbers of future employees, contractors, interns, and temporary workers to justify its space requirements, by assuming:
    - all new SEC positions would be located in D.C.;
    - a ratio of 20% -- contractors to employees (twice as much as is standard);
    - a ratio of 16.5% -- interns and temporary workers to employees, more than 3 times more than the actual ratio;
    - a 10% growth or "inventory" factor, double the standard;
    - SEC would obtain approval from OMB and Congress for the full SEC appropriation requests for FY2011, FY2012 and a 50% increase for FY2013.

- **Inflated Space Standards:** SEC further inflated the space requirements by using a standard of 400 square feet per person for needed space (GSA recommends 230 or lower). The use of this figure results in further inflation of the projected number of people. For example, the 400 square foot figure already includes 5% for growth and 10% for contractors and temporary workers.

- **Inflated Numbers Cut Viable Alternatives:** As a result of the inflated numbers, SEC's initial estimates that reflected a need for less than 300,000 square feet increased to more than 900,000 square feet. This led to the exclusion of a number of available commercial buildings in walking distance to the current SEC Headquarters near Union Station.

- **Lease Not Negotiated:** SEC signed an un-negotiated, 10-year lease just 5 days after approval by the Chairman of the SEC which was obtained in a meeting lasting approximately 10 minutes. The rush to sign the contract also led to the omission of standard lease terms intended to protect the government.

- **Violation of Contracting Rules:** SEC did not follow requirements of the Competition in Contracting Act (CCA) and the Federal Acquisition Regulations

[3] Id at p. 5.
[4] Id. at p. 10.

(FAR) that require full and open competition. An exception to this requirement can be "when the agency's need for the supplies or services is of such an unusual and compelling urgency that the Government would be seriously injured unless the agency is permitted to limit the number of sources from which it solicits bids or proposals."[5] The SEC IG concluded there was no unusual or compelling urgency or that the Government would be seriously injured had full and open competition occurred. In addition, the SEC IG found the *Justification and Approval For Other Than Full and Open Competition* generated by the SEC was publically noticed more than five weeks after the contract was signed (beyond the 30-day period required in the FAR); was backdated to make it appear it was approved earlier than it was; and had at least one date altered. Moreover, three of the four signatures required were signed separate from the document for which the signatories were attesting.

- **Lack of OMB Approval:** SEC may not have complied with OMB requirements for government leases by not submitting information to OMB pursuant to Appendix B of the OMB Circular No. A-11.

- **Possible Violation of Anti-deficiency Act:** The SEC may have violated the Anti-deficiency Act that prohibits officers or employees of the government from entering into an obligation or contract before an appropriation is made unless otherwise authorized by law.

- **Work Environment Discourages Questions:** The SEC IG found evidence of a rigid, closed, and hostile atmosphere within the Office of Administrative Services (OAS) (the SEC office responsible for leasing) that suggested employees with relevant experience were discouraged from questioning decisions.

Recommendations of the Inspector General

The IG recommended that the SEC:

"...carefully review the report's findings and conduct a thorough and comprehensive review and assessment of all matters currently under the purview of OAS including, but not limited to:

(1) The adequacy of written policies and procedures currently in place for all aspects of the SEC's leasing program, including, but not limited to, putting in place written procedures for leasing approvals;
(2) The methods and processes utilized to accurately project spacing needs based on concrete and supportable data;
(3) The determination to employ a standard of 400 square feet per person for planning Agency space needs;

[5] Id. at p. 68 (quoting 48 CFR § 6.3202-2).

(4) The necessity of retaining architects, furniture brokers, or other consultants to assist in the work generally performed by OAS officials; and
(5) All pending decisions in which OAS is committing the SEC to expend funds, including decisions relating to regional office lease renewals.[6]"

The SEC IG further recommended that the "Chief Operating Officer/Executive Director, upon conclusion of such review and assessment, determine the appropriate disciplinary and/or performance-based action to be taken for matters that are discussed in this report of investigation, as well as any other issues identified during the review and assessment, including, at a minimum, consideration of disciplinary action against Sharon Sheehan and, up to and including dismissal..."[7]

Finally, the SEC IG recommended that the "Office of Financial Management, in consultation with the Office of General Counsel, request a formal opinion from the Comptroller General as to whether the Commission violated the Antideficiency Act by failing to obligate appropriate funds for the Constitution Center lease."[8]

Problems Related to SEC Leases Pre-Date Constitution Center Lease

In 1990, Congress provided the SEC with independent leasing authority with the intent that such authority would be "exercised vigorously by the Commission to achieve actual savings and to increase the Commission's productivity and efficiency."[9] Despite this responsibility, the SEC did not establish a Leasing Branch until 2009, 19 years after being granted this authority. The SEC currently leases space in 12 cities[10] and the District of Columbia. These include its headquarters in D.C. and regional offices. The SEC manages approximately 2.4 million square feet of space at an average annual cost of $83 million. Questions regarding SEC's management of its leasing authority date back more than a decade. Some examples include:

- In 2001, the SEC leased space for its Regional Office in New York City and subsequently entered into a dispute with the landlord regarding the handling of asbestos allegedly found in the building. While the lease agreement assigned responsibility to the landlord, instead of addressing the issue, in 2004, the SEC issued a *Justification and Approval for Other than Full and Open Competition* to enter into a sole source lease agreement for other leased space. While SEC subsequently worked with GSA and the landlord to mitigate the costs, the SEC has paid more than

[6] Id. at p. 90.
[7] Id.
[8] Id. at p. 91.
[9] *Improper Actions Relating to the Leasing of Office Space, Report of Investigation,* Office of the Inspector General, U.S. Securities and Exchange Commission, May 16, 2011 (OIG-553), p. 19 (quoting House Conf. Report 101-924).
[10] These include Atlanta, Boston, Chicago, Denver, Fort Worth, Los Angeles, New York, Philadelphia, Salt Lake, San Francisco, and Alexandria (VA).

$15 million since 2005 for space that SEC has not occupied since that time.[11]

- In 2001, the SEC entered into a lease for new headquarters in D.C., known as Station Place One and subsequently exercised an option to lease Station Place Two. In 2005, SEC disclosed to the House Appropriations Committee that it had approximately $48 million of unbudgeted costs associated with the construction of the new facilities in D.C. and improvements in new leased facilities in New York and Boston.[12]

- In 2007, the SEC embarked on a "restacking" project at its D.C. headquarters building. Restacking is the movement of employees from one physical location in the building to another for purposes of better collaboration between employees. While the then-Chairman of the SEC requested that the Executive Director conduct a cost-benefit analysis prior to restacking or moving approximately 1,700 employees and initiating reconstruction, there is no evidence that a cost analysis was ever completed. The restacking cost the taxpayers $3 million and there is no evidence the restacking improved efficiency.[13]

- In 2009, the SEC's lease for the San Francisco Regional Office was expiring and despite taking steps to exercise a one-year extension while it conducted a full and open competition for replacement space, the extension was never executed and the SEC began paying a higher holdover lease rate. Subsequently, the SEC awarded the new lease to the existing landlord which allowed the SEC to negotiate a credit for the higher rate paid. However, SEC still paid excess rent totaling over $200,000.[14]

Witnesses

In addition to the witnesses listed, the Subcommittee also sent invitations to certain current and former SEC staff involved in the leasing of Constitution Center requesting they provide testimony. The witnesses have either refused to testify or, as of this memorandum, failed to respond to the Subcommittee request.

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[11] *See Real Property Leasing Procurement Process*, Office of Audits, Office of the Inspector General, U.S. Securities and Exchange Commission, September 30, 2010 (Report No. 484).
[12] *See U.S. Securities and Exchange Commission: Building Project Management and Related Budget Planning*, U.S. Government Accountability Office Letter to The Honorable Frank R. Wolf, Chairman, Subcommittee on Science, the Departments of State, Justice, and Commerce, and Related Agencies, Committee on Appropriations, U.S. House of Representatives, October 20, 2005 (GAO-06-61R).
[13] *See Review of the Commission's Restacking Project*, Office of Audits, Office of the Inspector General, U.S. Securities and Exchange Commission, March 31, 2009 (Report No. 461).
[14] *See Real Property Leasing Procurement Process*, Office of Audits, Office of the Inspector General, U.S. Securities and Exchange Commission, September 30, 2010 (Report No. 484).

WITNESSES

The Honorable H. David Kotz
Inspector General
U.S. Securities and Exchange Commission

Mr. Jeff Heslop
Chief Operating Officer/Executive Director
U.S. Securities and Exchange Commission
Accompanied by:
Mr. Mark D. Cahn
General Counsel
U.S. Securities and Exchange Commission

Ms. Elaine Clancy
Director of Leasing, National Capital Region
U.S. General Services Administration

ATTACHMENT

Timeline of Constitution Center Lease

June 2009	SEC decides to not exercise option to lease Station Place 3 (contiguous to its existing headquarters) due to uncertainty of budget. Station Place owner warns SEC it will lease to other potential tenants.
July 2009	SEC staff realizes need for space, General Counsel contacts owner regarding costs of buying out leases to other tenants.
August 2009	SEC decides to lease 200,000 square feet left in Station Place 3.
March 2010	SEC executes lease for 200,000 square feet of space at Station Place 3.
April/May 2010	SEC decides not to buy out the tenants in the remaining 200,000 square feet of space in Station Place 3.
May 7-10, 2010	SEC Office of Administrative Services (OAS) told of the 800 new employees expected but not to expect all to locate in D.C. (371 would be assigned to regional offices)
May 14, 2010	SEC submits authorization request to Senate authorizing committee for $1.5 billion in FY2012 for 800 positions.
May 27, 2010	OAS alerts staff there is an urgent need for new space in D.C. for 400 staff (~ 250,000 sq.ft.) and reaches out to 3 potential properties near Station Place headquarters.
June 2, 2010	OAS receives email from a real estate broker regarding Constitution Center.
June 11, 2010	OAS decides to solicit offers for space for 316,000 sq. ft. and expand the delineated area to include Constitution Center.
June 17, 2010	OAS and the Executive Director meet with the Chairman of the SEC and inform her of the need for 280,000 to 315,000 sq. ft. Chairman prefers locations closer to Station Place and questions if SEC needs that much space given much of the growth would be in the regional offices.
July 7-14, 2010	OAS's employee growth numbers in D.C. expanded.
July 20, 2010	New projections requiring over 900,000 square feet presented to Executive Director.
July 23, 2010	Executive Director recommends to SEC Chairman leasing 900,000 square feet at Constitution Center. Chairman approves after 10 minute meeting and after being told of urgent need to act.
July 28, 2010	SEC signs Letter Contract with Landlord for lease of 900,000 square feet at Constitution Center.
August 2, 2010	Three of four signatures needed to complete the

	justification for a sole source lease obtained before a final draft of justification completed.
August 27, 2010	Deadline for publically noticing justification under federal regulations.
August 31, 2010	Fourth signature needed for justification provided but backdated to August 27.
September 1, 2010	Significant revisions of justification sent to General Counsel.
September 2, 2010	Justification finalized.
September 3, 2010	Justification publically noticed with the date of the fourth signature altered.
September 7, 2010	OAS inquires of General Counsel regarding notifying OMB.
October 5, 2010	Draft lease action summary to OMB completed but never sent to OMB.
October 6, 2010	OAS meets with Chairman to inform her the budget will be flat and the SEC needs to find other federal agencies to assume 600,000 square feet of the space leased at Constitution Center.
November 11, 2010	Landlord begins negotiations with FHFA and OCC to lease space at Constitution Center.
November 19, 2010	Landlord sends email to SEC asking if SEC is prepared to reimburse the landlord's broker's fees and build out costs.
December 8, 2010	SEC informs Landlord that it agrees to a conditional release of space to be leased to FHFA and OCC but that the SEC would retain 300,000 square feet on floors 2-10 in the SW quadrant of the building.
January 2011	OCC and FHFA lease space at Constitution Center, leaving 350,000 square feet of the leased SEC space.
March 2011	SEC informs landlord it hopes to sublease some or all of the remaining space.