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Office of Inspector General
Office of Audits

Real Property Leasing Procurement Process



September 30, 2010
Report No. 484



OFFICE OF
INSPECTOR GENERAL

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

MEMORANDUM

September 30, 2010

To: Sharon Sheehan, Associate Executive Director, Office of Administrative Services (OAS)

From: H. David Kotz, Inspector General, Office of Inspector General *HM*

Subject: *Real Property Leasing Procurement Process*, Report No. 484

This memorandum transmits the U.S. Securities and Exchange Commission, Office of Inspector General's (OIG) final report detailing the results of our audit of the Real Property Leasing Procurement Process. This audit was conducted as part of our continuous effort to assess the management of the Commission's programs and operations and as a part of our annual audit plan.

This report contains 14 recommendations that were developed to strengthen the Commission's real property leasing procurement processes. OAS fully concurred with all of the report's recommendations. Your written response to the draft report is included in Appendix V.

Within the next 45 days, please provide the OIG with a written corrective action plan that is designed to address the agreed-upon recommendations. The corrective action plan should include information such as the responsible official/point of contact, time frames for completing the required actions, and milestones identifying how you will address the recommendations cited in the report.

Should you have any questions regarding this report, please do not hesitate to contact me. We appreciate the courtesy and cooperation that you and your staff extended to our staff during this audit.

Attachment

cc: Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman
Diego Ruiz, Executive Director, Office of the Executive Director
David Becker, General Counsel, Office of General Counsel
John Branch, Assistant Director, Office of Administrative Services,
Real Property and Facilities Support

Real Property Leasing Procurement Process

Executive Summary

Background. In 1990, Congress provided the Securities and Exchange Commission (SEC or Commission) with independent leasing authority and, at the same time, exempted the SEC from General Services Administration (GSA) space management's regulations or directives. In doing so, Congress intended that the SEC would exercise this independent leasing authority vigorously in order to achieve cost savings and increase the SEC's productivity and efficiency. Pursuant to its independent leasing authority, the SEC enters into commercial leases for all of the agency's office space. The SEC does not own any of its facilities.

The SEC's real estate leasing function is managed primarily by the Real Property and Leasing Branch (Leasing Branch) of the Office of Administrative Services (OAS), which was established in April 2009. Leasing authority is centralized within OAS, and the SEC's regional offices do not have any independent authority to enter into real property leases.

Other OAS components that have responsibilities that impact the SEC's real estate leasing program include OAS's Security, Construction, Space Management, and Facilities Branches, as well as the Office of Acquisitions. Other SEC offices that have significant interaction with the leasing program are the Office of Information Technology (OIT) and the Office of Financial Management (OFM). The Associate Executive Director of OAS serves as the SEC's Senior Procurement Executive (SPE). Under agency contracting policies, the SPE appoints a Realty Contracting Officer, who has delegated, express written authority for realty leasing on a contracting officer's warrant.

The SEC currently maintains 2,482,576 square feet of leasehold interests. These include leases for SEC headquarters facilities located in Washington, D.C., as well as leases for all of the SEC's regional offices located throughout the United States. The SEC made total lease payments of approximately \$83.8 million in both Fiscal Years 2008 and 2009, representing approximately 9 percent of the SEC's total budget authority for these years. It is anticipated that the SEC's leasing program and leasing costs will increase over the next few years as the agency expands to meet new responsibilities.

Objectives. The Office of Inspector General (OIG) conducted its audit to determine whether OAS had established real property leasing policies and procedures and to examine whether these policies and procedures were consistently followed and in compliance with applicable federal laws, rules, and regulations. Our audit was also performed to ascertain how the Leasing Branch maintains and tracks the SEC's real property leases. Lastly, our audit sought to

identify the SEC's current leases and assess whether the lease requirements were appropriate and to assess whether the SEC received the best value for its leasing investments.

Results. Overall, our audit found that the SEC's Leasing Branch does not have adequate policies in place and, until very recently, had no final leasing policies and procedures. Our audit also determined that the absence of adequate leasing policies and procedures led to certain situations in which the SEC was required to make lease payments that could have been avoided if appropriate policies and procedures had existed and been followed consistently.

Significantly, our audit determined that the primary leasing policy document, Securities and Exchange Commission Regulation (SECR) 11-03, "SEC Leasing Program," which was finalized months after our audit fieldwork was completed, is incomplete and inadequate. Further, the SEC's Leasing Program Operating Procedures (OP 11-03), which supplements SECR 11-03, is also inadequate and remains in draft form.

The audit noted the following specific deficiencies in the SEC's leasing policies and procedures. First, SECR 11-03 is incomplete as it does not list or describe all of the legal requirements and guidelines relevant to real property leasing. The SECR also fails to enumerate the specific objectives of the SEC's leasing program and provides no instructions or guidance to facilitate compliance with relevant authorities. While the SEC, by statute, is exempted from strict adherence to GSA space management regulations or directives, the SEC could benefit significantly by looking to the GSA regulations on leasing and management of real property as a guide, and evaluating, assessing and implementing these regulations, as deemed appropriate.

Second, while the SEC's Office of General Counsel (OGC) has identified SECR 11-03 as the SEC's asset management plan required by Executive Order 13327, "Federal Real Property Asset Management," the OIG's review of SECR 11-03 revealed that it falls well short of being an adequate asset management plan. The OIG found that SECR 11-03 was an insufficient asset management plan because it did not set forth any objectives for the real property leasing function, did not specify resource requirements to support real property leasing, and contained virtually no information pertinent to lease administration. Specifically, the audit noted that SECR 11-03 does not include the required components of an asset management plan that are set forth in guidance issued by the Federal Real Property Council (FRPC).

Third, the audit found that OAS did not have sufficient procedures for how leases should be managed and tracked. While we found that the Leasing Branch had a document that described the rent payment process and that staff manually tracked monthly lease payments on a spreadsheet, the Leasing Branch does not separately track amounts paid for operating expenses, property taxes or repairs.

The audit concluded that the lack of such detailed payment data hinders the SEC's ability to monitor expenses incurred during the operational phase of a lease, and that such information would be useful in making future leasing decisions and formulating the annual budget for leased properties.

Fourth, the audit found that although the SEC's five-year draft strategic plan includes a strategic goal that encompasses enhancement of the Commission's performance through the effective alignment and management of financial capital, the SEC has no specific goals or performance measures for real property leasing, even though the SEC expends approximately \$83.8 million per year on real property leases. The audit noted that without such goals and performance measures, OAS is unable to employ a continuous monitoring and feedback mechanism, which is a required component of a sufficient asset management plan.

As mentioned above, the OIG's audit revealed certain specific instances in which the failure to have in place, and to adhere to, adequate leasing policies and procedures resulted in additional costs to the agency.

One of these situations involved the planning for the competition or renewal of a building lease for the San Francisco Regional Office (SFRO) that was expiring at the end of October 2009. The OIG audit found that OAS changed its plan to negotiate a lease with the current landlord due to market information showing a dramatic drop in rental rates in the San Francisco office market. As a consequence, OAS decided to conduct a full and open competition and prepared a sole source justification for a one-year extension of the existing lease to allow sufficient time to negotiate a long-term solution. According to the sole source justification document, OAS expected to negotiate a price of approximately \$42.24 per rentable square foot (rsf) for the one-year extension. The one-year extension was never executed; however, and, beginning on November 1, 2009, the SEC began paying rent at a higher holdover rate of over \$60 per rsf.

After conducting a competition, the SEC awarded a new 10-year lease to the current landlord. The new lease, which was signed on April 9, 2010, expanded the existing office space and provided for annual rent of \$41 per rsf, increasing by \$1 each year; however, the new rate does not commence until construction of the 25th floor is completed and accepted. The SEC continued to pay rent at the higher hold over rate for approximately six months until it signed the lease. At that time, the landlord, consistent with its previous offer, agreed to credit the difference between the holdover rate and the lease rate in effect as of October 31, 2009, of \$53.34 per rsf, and the SEC will continue to pay rent at this rate until the new lease becomes effective.

The OIG found that the failure to extend the previous lease prior to its expiration, or to enter into a new one on a timely basis resulted in the SEC, during a time of declining market rental rates, paying rent at rates substantially higher than the

rate it would have paid, had it executed the one-year lease extension contemplated by the sole source justification. Specifically, we calculated that even with the credit obtained after the new lease was signed, the SEC paid excess rent totaling \$203,000 between November 2009 and March 2010. While OAS indicated that it performs acquisition planning, the OIG audit found that the SEC's written leasing policies and procedures do not adequately address timely acquisition planning and do not require the preparation of adequate project plans. The OIG concluded that improved policies and procedures for lease planning would better enable OAS to anticipate and react to changed circumstances.

In another situation involving the lease of office space in New York City, the OIG found that the SEC, for several past years and continuing into the future, was obligated to make simultaneous payments for two office properties, one of which it no longer occupies. Specifically, the OIG found that after asbestos was discovered in the office location it had leased since late September 2001, the SEC had a dispute with the landlord regarding how the situation should be handled, and discussions with regard to an expansion in the existing location came to an end. The SEC then decided to relocate its New York Regional Office (NYRO) and enter into a lease at another site. However, the SEC was still responsible for payments under the initial lease, as it believed it could not demonstrate that the landlord had breached the terms of the lease, which included a default clause, but not a termination for convenience clause.

In April 2004, SEC officials executed and approved a justification for other than full and open competition to obtain a new NYRO lease on the basis of unusual and compelling urgency. The justification was conditioned on the provision that the successor landlord assume the SEC's remaining obligations at the existing lease site. The SEC entered into a lease for a new NYRO office location in March 2005; however, the new landlord did not assume any of the SEC's remaining obligation at the previous site (although the landlord did agree that the SEC would be responsible only for operating expenses during the first year of the lease). The SEC contacted GSA, which found a tenant for the SEC's former office location. Also in March 2005, the SEC entered into a wrap around lease and surrender agreement, which terminated the SEC's previous lease provided that the SEC made certain payments to the landlord, and the landlord and GSA executed a lease for the premises (which they did).

As a consequence of the circumstances described above, the SEC has made since May 2005, and continues to make, simultaneous payments for office space at two locations in New York City. The OIG calculated that the SEC paid over \$15 million between May 31, 2005 and March 31, 2010 for property that no SEC employees have occupied since June 2005. During this same time period, the SEC made payments of over \$35 million to lease its current NYRO facility. Under the terms of its current lease and the wrap around lease and surrender agreement, the SEC will continue to make simultaneous payments until March 2012. The OIG audit determined that the lack of SEC guidance for evaluating

options prior to vacating leased space, or for including a termination for convenience clause or a broader, more inclusive default clause in a lease, or using flexible lease terms, contributed to the SEC paying millions of dollars for space it did not occupy.

A final situation where insufficient policies and procedures contributed to increased costs pertained to the evaluation of security requirements at a site in Alexandria, Virginia, where the SEC entered into a short-term lease for temporary office space, occupying a single floor of a four-floor building. While the audit found that the Leasing and Security Branches have been working to coordinate their efforts since the chiefs of those branches arrived at the SEC in 2008, improved coordination between these branches is needed. Further, although the Security Branch has developed two documents to be used in connection with proposed SEC office locations – a Building Security Survey and a Security and Safety Assessment, the OIG identified additional important information that should be included in the Security and Safety Assessment.

In addition, the OIG audit found that neither the Building Security Survey nor the Security and Safety Assessment were used in connection with the Alexandria, Virginia short-term lease. Because it was determined that the facility was located in a high crime area, the SEC explored options for appropriately securing the facility. OAS determined that the cost of developing computerized access for the building was too high. OAS decided that the most cost-effective option to place unarmed guards on the floor occupied by the SEC at the SEC's expense and for the SEC to pay the landlord, pursuant to a lease amendment, to hire an off duty police officer to patrol the area at a cost of \$200,000 per year. Thus, the SEC is paying for an armed off duty police officer at a facility where it occupies only one of four floors. Our audit found that if the appropriate security documents had been used in connection with this lease, the Leasing Branch would have been better equipped to negotiate for adequate security of the facility to be provided as part of the initial lease document.

Summary of Recommendations. Our audit determined that several improvements in the real property leasing process are needed to ensure that the SEC exercises its independent leasing authority vigorously and achieves cost savings and increased productivity and efficiency, as Congress intended.

Specifically, we recommend that OAS:

- (1) Revise SECR 11-03 and draft OP 11-03 to ensure that they are adequate and complete and include the information identified in this report, finalize OP 11-03 and the attachments thereto, and ensure that the revised documents are posted to the Commission's Intranet site and circulated to all staff with leasing responsibilities;

- (2) Amend SECR 11-03 to include a complete list of relevant authorities that apply to real property leasing and finalize detailed guidance to ensure compliance with those authorities;
- (3) Measure the SEC's real property leasing policies and procedures against pertinent provisions of GSA regulations, including the GSA Acquisition Manual and Subpart C of the Federal Management Regulation, as appropriate;
- (4) Ensure that the Leasing Branch's policies and procedures, including OP 11-03 and the attached checklists, provide comprehensive guidance for SEC leasing officials regarding the leasing process to assist in ensuring compliance with applicable policies, regulations and best practices;
- (5) Utilize the "Required Components" Section of the FRPC's Guidance for Improved Asset Management to develop and finalize the SEC's real property leasing asset management plan, as appropriate;
- (6) Amend its leasing policies and procedures to require the tracking and monitoring of all leasing expenses (*i.e.*, rent, operating costs and taxes) for informational and budget formulation purposes;
- (7) Develop performance goals for the SEC's real property leasing activities, including both lease acquisition and the monitoring and administration of existing leases, identify key external factors that could significantly affect the achievement of these goals, and periodically evaluate whether these goals are met;
- (8) Develop performance measures to assist in evaluating the effectiveness of the major functions of real property acquisitions and operations and periodically evaluate performance based on these measures;
- (9) Revise SECR 11-03 and draft OP 11-03 to include complete written policies for timely acquisition planning pertinent to real property leases, including the preparation of project plans and schedules with projected dates for achieving milestones well in advance of the scheduled commencement of a lease;
- (10) Adopt evaluation procedures that involve scoring and ranking various options prior to deciding to vacate leased premises or to terminate a lease, and develop a transparent methodology for formulating scores and rankings;

- (11) In consultation with the OGC, ensure that the SEC's real property leases provide appropriate protections in the event the SEC needs to terminate a lease before its expiration date;
- (12) Revise the Security and Safety Assessment document to include more specific information, such as the number of recent incidents in the vicinity, the likelihood that future incidents will occur or vulnerabilities will be exploited, recommended countermeasures and the cost estimates for such countermeasures;
- (13) Implement final policies and procedures to ensure that the Leasing Branch consistently includes the Building Security Survey document in all solicitations for leased space; and
- (14) Implement final policies and procedures to ensure the Security Branch performs a physical review of prospective building locations and determines the threat within the immediate area prior to entering into a lease for any facility.

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Background and Objectives

Background

Section 4(b)(3) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78d(b)(3), gives the U.S. Securities and Exchange Commission (SEC or Commission) independent leasing authority and exempts it from General Services Administration (GSA) space management regulations or directives. Specifically, that section, which was added by Public Law 101-550, the Securities Acts Amendments of 1990, enacted on November 15, 1990, provides as follows:

Leasing Authority. Notwithstanding any other provision of law, the Commission is authorized to enter directly into leases for real property for office, meeting, storage, and such other space as is necessary to carry out its functions, and shall be exempt from any General Services Administration space management regulations or directives.

All SEC office facilities are housed in commercially leased space, and the SEC does not own any of its facilities. Currently, the real estate leasing function at the SEC is managed primarily by the Real Property and Leasing Branch (Leasing Branch) within the Office of Real Property Operations of the Office of Administrative Services (OAS).¹ Leasing authority is centralized within OAS, and the SEC's regional offices have no independent authority to enter into real property leases.

The Leasing Branch was established in April 2009 and includes eight positions: an SK-15 Branch Chief, three SK-14 Lead Realty Specialists (one of which is vacant), two SK-13 Realty Specialists, one SK-14 Business Finance Specialist, and one SK-7 Secretary (Administrative Support). The Branch Chief, who initially joined the SEC in July 2008, and other Branch staff members have previous GSA leasing experience. The Leasing Branch staff acquires leasehold interests in real property and performs budget execution activities for all leases. They also provide lease administration with respect to leases for which those responsibilities have not been delegated to the Space Management or Facilities Branches or the regional office Administrative Officers (AOs).

Other components of OAS also have responsibilities that impact the SEC's real estate leasing program. For example, the OAS Security Branch is responsible for determining the securities standards for SEC facilities and designates a security level for space requirements. The OAS Construction Branch is responsible for overseeing the design phase of the project, including tenant

¹ The Chief of the Leasing Branch reports to the Assistant Director for the Office of Real Property Operations, who in turn reports to the Associate Executive Director, OAS.

improvement pricing analysis and estimating, and the build-out of leased space. The OAS Office of Acquisitions is responsible for overseeing the acquisition of goods and services within the SEC.²

The Associate Executive Director of the OAS serves as the SEC's Senior Procurement Executive (SPE).³ The "SPE is responsible for the overall management of acquisition policy at [the] SEC, including establishing and implementing policy."⁴ The "SPE monitors the overall effectiveness and efficiency of the contracting functions; and establishes controls to assure compliance with laws, regulations, and procedures."⁵ The SPE is appointed by the Executive Director, and this "appointment is for the duration of SPE's employment as the Associate Executive Director of OAS."⁶

The Realty Contracting Officer (RCO) is "an employee of OAS with express written authority for realty leasing delegated by [the] SPE on a contracting officer's warrant."⁷ The RCO is appointed by the SPE, who "has the authority to select, appoint, alter and rescind a RCO warrant."⁸ "A RCO appointment is made on a Certificate of Appointment, which is signed by the SPE, and which will designate on its face any limits to the dollar amount of the appointment."⁹ Further, "RCO warrants are limited to Realty Leasing, and a RCO is not required to hold a" Federal Acquisition Certification for Contracting (FAC-C).¹⁰

The SEC OIG performed a previous audit of the SEC's real estate leasing function and issued *Real Property Leasing*, Report No. 330, on May 31, 2001. The audit's objective was to determine whether real property leasing procedures complied with applicable guidance and were efficient and effective. While the audit found that the SEC's procedures for leasing generally complied with applicable guidance, it also included six recommendations for enhancing management of the leasing program.

² The Assistant Director of the Office of Acquisitions reports directly to the Associate Executive Director of OAS, while the Chief of the Construction Branch reports to the Assistant Director for the Office of Real Property Operations, and the Chief of the Security Branch reports to the Assistant Director for Security, Publishing, and Mail Operations.

³ SEC Contracting Authorities and Appointments, SECR 10-02 (REV2), March 31, 2010, Section 1.4(A).

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*, Section 2(A).

⁷ *Id.*, Section 1.4(H).

⁸ *Id.*, Section 2(G).

⁹ *Id.*

¹⁰ *Id.* FAC-C is a certification program of the Federal Acquisition Institute (FAI) that "outlines the training, education and experience requirements necessary for contracting professionals to be certified." See <http://www.fai.gov/certification/specialist.asp>.

The SEC maintains 2,482,576 square feet of leasehold interests in the following locations shown in Table 1:

Table 1: SEC Lease Locations

Lease Locations:	
Atlanta	New York
Boston	Philadelphia
Chicago	Salt Lake
Denver	San Francisco
Fort Worth	Alexandria, VA
Los Angeles	Washington, D.C.
Miami	

Source: OIG Generated

The SEC made total lease payments in the amount of \$83,793,456.20 in Fiscal Years (FY) 2008, and \$83,829,952.76 in FY 2009. This represents approximately 9.2 percent and 8.6 percent of the SEC's total budget authority for these FYs, respectively. The SEC's leasing program is expected to grow, and leasing costs are expected to increase over the next few years as the agency expands in order to meet new responsibilities, including those arising under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, enacted on July 21, 2010.

Objectives

The objectives of our audit were to determine whether OAS had established real property leasing policies and procedures and to examine whether these policies and procedures were consistently followed and in compliance with applicable federal laws, rules, and regulations. Our audit was also performed in order to ascertain how the Leasing Branch maintains and tracks the SEC's real property leases. Lastly, our audit sought to identify the SEC's current leases and assess whether the lease requirements were appropriate and the SEC received the best value for its leasing investments.

Findings and Recommendations

Finding 1: The SEC's Leasing Policies and Procedures Are Inadequate and Incomplete

The policies and procedures governing the SEC's real estate leasing program are inadequate and incomplete in significant respects, and the operating procedures and checklists are still in draft form.

SEC Leasing Policies and Procedures. As discussed above, in giving the SEC independent leasing authority, Congress exempted the SEC from GSA space management regulations or directives. Our audit found that, while the SEC has had independent leasing authority since November 1990, approximately 20 years later, the SEC presently does not have adequate policies and procedures in place for the SEC's real estate leasing program.¹¹ It is critical that the SEC has adequate policies and procedures in place to ensure that leasing decisions are made properly and are in compliance with applicable laws, directives and best practices, and that the SEC receives the best value for its investment. In fact, Congress intended "that the authority granted the Commission to lease its own office space directly [would] be exercised vigorously by the Commission to achieve actual cost savings and to increase the Commission's productivity and efficiency."¹²

On May 25, 2010, after we commenced our audit, OAS provided us with a draft Securities and Exchange Commission Regulation (SECR) 11-03, SEC Leasing Program, which was intended to prescribe the policies and procedures governing the SEC's acquisition of leasehold interests in real property. OAS has informed us that SECR 11-03 was recently finalized and was approved by the Executive Director on August 31, 2010. The SECR 11-03, excluding the cover page, table of contents and attachments, is nine pages in total length and includes over three pages of definitions. The stated purpose of SECR 11-03 is to establish "uniform policies and procedures for the acquisition and administration of leasehold interests in real property for the [SEC]."¹³ The SECR also states that "[t]he SEC will adhere to executive orders and other legal requirements applicable to federal executive agencies acquiring interests in real property (e.g., National Environmental Policy Act, Randolph Shepherd Act, Federal Fire Safety Act of

¹¹ According to OAS, prior to the establishment of the Leasing Branch, written leasing policies were contained in former SECR 5-8, Space Management Program (August 18, 2005), but this document did not effectively address the leasing procurement process.

¹² House Conference Report No. 101-924, 101st Cong., 2nd Sess. 1990 at p. 20, reprinted in 1990 U.S.C.C.A.N 3929.

¹³ SECR 11-03, Section 1, Purpose and Scope, at p. 1.

1992, etc.).”¹⁴ It further provides that “[t]o the extent certain Federal Acquisition Regulation (FAR) provisions are required by law or statute, the SEC will adhere to them to acquire and administer leasehold interests in real property.”¹⁵ SECR 11-03 also contains very brief descriptions of the responsibilities of various Commission officials and offices for real property leasing; requires compliance with various requirements, including certain FAR provisions, Office of Management and Budget (OMB) notification requirements and the Anti-Deficiency Act; and establishes the Rural Development Act¹⁶ requirements for the SEC. The SECR 11-03 has three attachments: a Leasing Acquisition Plan, a Notification of Lease Action Memorandum, and an OMB Lease Action Summary for Planning, Budgeting, Acquisition and Management of Capital Assets.¹⁷

OAS also provided us with a draft of the SEC Leasing Program Operating Procedures (OP 11-03), which is three pages long and includes draft attachments containing checklists and guidance for completing those checklists. Specifically, the draft attachments include a Lease Project Checklist, a Design and Construction Checklist, and a Lease Administration Checklist. For each checklist, there is a document providing short explanations for each item and including a hyperlink to regulations or template forms, if applicable. The draft OP 11-03 indicated that the Leasing Branch planned to issue an internal leasing handbook by October 2010.¹⁸ However, OAS subsequently stated that OAS now intends to continue to refine its checklists guidance in lieu of issuing a handbook.

As discussed below, our audit found that the policies and procedures for the SEC leasing program are inadequate and incomplete in significant respects and need to be enhanced. The OIG notes that after the OIG brought the deficiencies in OAS’s draft leasing policies and procedures to its attention, OAS nonetheless finalized SECR 11-03 on or about August 31, 2010, with minimal changes and without regard to correcting the deficiencies OIG identified. Overall, SECR 11-03 does not list or describe all of the relevant legal requirements or guidelines, such as: Executive Order 12072, Federal Space Management; Executive Order

¹⁴ *Id.*, Section 4. Policy, at p. 1.

¹⁵ *Id.* “The FAR is the primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services with appropriated funds. It became effective on April 1, 1984, and is issued within applicable laws under the joint authorities of the Administrator of General Services, the Secretary of Defense, and the Administrator for the National Aeronautics and Space Administration, under the broad policy guidelines of the Administrator, Office of Federal Procurement Policy, Office of Management and Budget.” <http://www.gsa.gov/portal/content/104647>. “The FAR precludes agency acquisition regulations that unnecessarily repeat, paraphrase, or otherwise restate the FAR, limits agency acquisition regulations to those necessary to implement FAR policies and procedures within an agency, and provides for coordination, simplicity, and uniformity in the Federal acquisition process. It also provides for agency and public participation in developing the FAR and agency acquisition regulation.” *Id.*

¹⁶ Section 601 of the RDA, Public Law 92-419, enacted on August 30, 1972, required executive department and agencies to establish and maintain policies and procedures to give first priority to the location of new offices and facilities in rural areas.

¹⁷ These attachments were not provided to the OIG during the course of the audit fieldwork; rather, the OIG obtained the attachments for the first time on September 8, 2010, at the time a copy of the final SECR 11-03 was provided to the OIG.

¹⁸ Draft SEC OP 11-03, SEC Leasing Program Operating Procedures, Section 3.3.

13006, Locating Federal Facilities on Historic Properties in Our Nation's Central Cities; Executive Order 13327, Federal Real Property Asset Management; OMB Circular, A-11, Preparation, Submission, and Execution of the Budget, Part 2, Preparation and Submission of Budget Estimates, Section 33.1, Construction, Leases of Capital Assets, and Acquisition of Real Property; OMB Circular A-94, Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs; and Office of Federal Procurement Policy Letter 05-01 Subject: Developing and Managing the Acquisition Workforce. The last bullet of Section 7 of the SECR states that the requirements of executive orders and public laws that are applicable to lease acquisitions are too numerous to list in the SECR, are subject to change, and are further addressed in OP 11-03.¹⁹ In addition, OAS pointed out that legal authorities such as Executive Order 12072, Executive Order 13006, OMB Circular A-11 and budget submission requirements and disclosure rate calculations for present value analysis are included in the Leasing Operating Procedures checklists. Nonetheless, the OIG believes it is important that these documents also be referenced in the SECR, which is the controlling policy document. The references could be included in an Appendix to the SECR, which could easily be updated as changes occur.

Further, as noted below in the discussion of asset management plan components, beyond stating that the SEC will adhere to legal requirements, the SECR does not enumerate any specific objectives the SEC hopes to achieve with its leasing program. Also, the SECR does not provide instructions or step-by-step guidance necessary to facilitate compliance with relevant authorities. For example, while the SECR states that the Leasing Branch will “[p]romote the competition requirements of FAR Part 6,”²⁰ the document provides no further guidance for ensuring compliance with this lengthy and complex part of the FAR that contains multiple subparts.

Although the SEC, by statute, is not strictly required to abide by GSA space management regulations or directives, the SEC could significantly benefit from performing an evaluation of GSA policies and procedures and assessing which provisions could be adopted to improve the SEC's leasing program by establishing some basic guidance or standards to be utilized in the real property leasing process. The GSA has issued extensive regulations on leasing and management of real property, including the General Service Administration Acquisition Manual (GSAM)²¹ and Subchapter C of the Federal Management Regulation (FMR).²² These documents provide procedures for, among other things, efficient contracting, including soliciting and evaluating competitive offers (GSAM Subpart 570.3), safeguarding against improper business practices and

¹⁹ SECR 11-03, Section 7, at p. 8.

²⁰ SECR 11-03, Section 7, at p. 6.

²¹ “The GSAM incorporates the General Services Administration Acquisition Regulation (GSAR) as well as internal agency acquisition policy.” <http://www.gsa.gov/portal/content/101180>.

²² “The FMR is the successor regulation to the Federal Property Management Regulation (FPMR). It contains updated regulatory policies originally found in the FPMR.”

<http://www.gsa.gov/portal/content/104792>. Subchapter C of the FMR pertains to Real Property.

personal conflicts of interest (GSAM Part 503), and energy conservation (FMR §§ 102-74.155 through 102.74.200). While OAS stated the SEC has assessed GSA's Lease File Checklist and associated guidance, the OIG notes that the referenced document is over five-years old (it is dated June 28, 2005), and is limited in subject matter scope to the requirements for lease files.

Asset Management Plan Required by Executive Order 13327. Executive Order 13327 (February 4, 2004), entitled, "Federal Real Property Asset Management," imposes various requirements on federal agencies "in order to promote the efficient and economical use of Federal real property resources in accordance with their value as national assets and in the best interest of the Nation."²³ While certain Executive Order's requirements do not apply to the SEC, the SEC does fall under the purview of Section 6 of the Executive Order, which provides that the "Director of the Office of Management and Budget shall review, through the management and budget review processes, the efforts of departments and agencies in implementing their asset management plans and achieving the Government-wide property management polices established pursuant to this order."²⁴

The SEC's Office of General Counsel (OGC) has indicated that SECR 11-03 accomplishes the requirement that the SEC have an asset management plan. However, our review of the SECR 11-03 revealed that this document is not an adequate asset management plan. Most fundamentally, the SECR does not set forth any of the SEC's objectives for the real property leasing function. Further, the SECR does not specify resource requirements to support real property leasing at the SEC. Nothing in the SECR refers to the number of employees or the amount of funding that will need to be directed toward the real estate leasing program. While OAS noted that resource requirements are not appropriate information to include in an SECR, the OIG believes that this is important information to have in an asset management plan.

In addition, although the stated purpose and scope of SECR 11-03 is to establish "uniform policies and procedures for the acquisition *and administration* of leasehold interests in real property" for the SEC,²⁵ the SECR pertains almost entirely to acquisition and includes almost no material related to lease administration. Specifically, SECR 11-03 does not provide for periodic evaluation of the SEC's real property assets. While it contains some guidelines for entering into leases and alterations in existing leased space, the SECR does not provide for continuous monitoring or feedback during the life of the lease.

In fact, the SECR 11-03 contains virtually no guidance for managing a lease throughout the lease term. The leases for the SEC's regional offices are managed by the Realty Specialists located in Leasing Branch at Headquarters,

²³ Executive Order 13327, Federal Real Property Asset Management (Feb. 4, 2004), § 1.

²⁴ *Id.*, § 6(a).

²⁵ SECR 11-03, Section 1, Purpose and Scope, at p. 1 (emphasis supplied).

with the assistance of AOs employed by the regional offices. However, SECR 11-03 does not address the AOs' roles and responsibilities for the day-to-day management of leases. OAS staff indicated during the audit that there is no uniform management plan concerning leases at different sites. OAS staff explained that the problems that may occur differ greatly depending on the location, so it would be impractical to implement a uniform method of management. Instead, an informal best practices approach is used to manage the leasing process.

Although the SEC is not an agency that must designate a Senior Real Property Office pursuant to Section 3 of Executive Order 13327 and is, therefore, not represented on the Federal Real Property Council (FRPC), Section 4 of the Executive Order states that the Council is established within OMB "for administrative purposes, to develop guidance for, and facilitate the success of each agency's asset management plan."²⁶ The FRPC, pursuant to Executive Order 13327, has issued detailed guidance that specifies the following required components of an agency asset management plan:

1. Integrated Guiding Principles
2. Agency-Specific Owner's Objectives
3. Periodic Evaluation of All Assets
4. Prioritized Operations and Maintenance and Capital Plans
5. Identified Resource Requirements to Support Plans
6. "Building Block" Asset Business Plans in Agency Portfolio Context
7. Continuous Monitoring and Feedback Mechanism
8. Consideration of Socio-Economic-Environmental Responsibilities
9. Adequate Human Capital Support of Asset Management Organization
10. Common Government-wide Terminology²⁷

In order to ensure that the SEC has an adequate asset management plan, OAS should carefully review these required components and make certain that the SEC's asset management plan addresses each of these elements.

Lack of Procedures for Tracking Costs Associated with Leases. Our audit found that OAS does not have sufficient written procedures that address how leases should be managed and tracked. OAS's policies and procedures do not address what information related to its lease operating expenses should be tracked and monitored. The Leasing Branch did provide a document titled, "Current Rent Payment Process," which describes the steps to be taken in connection with rent payments. This document states that prior to processing rent vouchers for payment, lease rent schedules, rent invoices, or other correspondence that might affect the lease payment are reviewed to determine

²⁶ Executive Order 13327, § 4.

²⁷ Federal Real Property Council, Guidance for Improved Asset Management, December 22, 2004, Section III. Asset Management Plan – Required Components.

the appropriate amount of the rent payment. The document also addresses the verification of funding availability, what steps should be taken if funds are not sufficient to cover the monthly expenditure, and submitting vouchers and supporting documentation to the Office of Financial Management (OFM) for payment. However, the tracking of monthly lease payments, as well as other related payments, is not addressed in this document.

During our audit, we learned that OAS Leasing Branch staff manually track on a spreadsheet the monthly lease payments, unliquidated obligations, and unliquidated balances. Other payments, such as operating expenses, property taxes or repairs, are also reflected in the spreadsheet, but are only tracked as a lump-sum amount, rather than individually. The lack of detailed payment data adversely affects the SEC's ability to monitor expenses incurred during the operational phase of the lease. By separately tracking costs, the SEC will know whether, and by how much, these costs have varied from year to year. Such information is valuable to management in making future leasing decisions and can also be used to facilitate the annual budget formulation for leased properties. OAS's current method of tracking costs does not contribute to a sound analysis of financial performance and operating efficiency.

Performance Measures Are Needed. The SEC has published for comment a draft strategic plan for FYs 2010-2015, which sets forth performance goals and measures.²⁸ Strategic Goal 4 of the draft plan states, "Enhance the Commission's Performance through Effective Alignment and Management of Human, Information and Financial Capital."²⁹ The draft plan provides that "[t]he SEC also is extremely mindful of its responsibility to optimize the use of its resources because it is a government agency entrusted with taxpayer funds."³⁰ The draft plan further states that "the SEC must continually direct its financial resources to their highest and best use, always subject to strong internal controls."³¹ However, the draft plan does not include performance measures that address real property leasing, even though the SEC leases approximately 2.5 million square feet of space at an average cost of approximately \$83.8 million per year.

OAS staff informed us during the audit that the Leasing Branch is not required to have independent goals apart from OAS's general goals and does not produce performance reports regarding individual leases. According to OAS, with respect to regional office leases, the day-to-day performance monitoring is usually handled by the regional office AOs, which are designated as official Contracting Officer's Representatives for lease oversight. According to OAS, the AOs are the first line of response to problems in tenant space and can directly access the building property manager for resolution of the types of issues that frequently

²⁸ U.S. Securities and Exchange Commission, Strategic Plan for Fiscal Years 2010-2015, Draft for Comment, <http://www.sec.gov/about/secstratplan1015.pdf>.

²⁹ *Id.* at 41.

³⁰ *Id.*

³¹ *Id.*

arise, such as problems with utilities and maintenance. OAS stated that, if such issues are not resolved, the Leasing Branch becomes involved for any further or more stringent lease actions, such as rent deductions, under the default provisions of the leases. OAS staff maintains overall authority concerning these issues and communicates directly with the regional AOs that are responsible for the day-to-day monitoring. The OAS Leasing Branch Chief generally tracks problems that occur at lease sites by maintaining email records containing information about complaints, but indicated that there are generally few major problems with leases and that these problems are tracked by the landlord.

Our audit found, therefore, that OAS has no written performance goals for its real property leasing activities (operational processes, skills and technology, human capital, information, and other required resources) and, as a consequence, no written performance measures to evaluate the goals and assure that goals are achieved. Without established performance goals and measures, OAS will not be able to employ a continuous monitoring and feedback mechanism which is a required component of an asset management plan (see page 8 above).

Recommendation 1:

The Office of Administrative Services (OAS) should revise Securities and Exchange Commission (SEC) Regulation 11-03 and draft Operating Procedure 11-03 (OP 11-03) to ensure that they are adequate and complete and include the information identified in the audit report, and should finalize OP 11-03 and the attachments thereto. OAS should ensure that the revised documents are posted to the Commission's Intranet site and that copies are circulated to all staff within the SEC's Real Property Leasing Branch, as well as other SEC staff with leasing-related responsibilities.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 2:

The Office of Administrative Services should amend Securities and Exchange Commission (SEC) Regulation 11-03 to include a complete list of relevant authorities (federal statutes, regulations, executive orders, Office of Management and Budget circulars, and internal SEC policies) that apply to real property leasing and should finalize detailed guidance to ensure compliance with those authorities.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 3:

The Office of Administrative Services should measure the Securities and Exchange Commission's real property leasing policies and procedures against pertinent provisions of General Services Administration (GSA) regulations, including the GSA Acquisition Manual and Subchapter C of the Federal Management Regulation, as appropriate.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 4:

The Office of Administrative Services should ensure that the Leasing Branch's policies and procedures, including Operating Procedure 11-03 and the attached checklists, provide comprehensive guidance for Securities and Exchange Commission (SEC) leasing officials regarding the leasing process that will assist in ensuring compliance with the applicable policies, regulations and best practices. These materials should detail the regulations and policies that should be followed at the various stages of the leasing process and should include pertinent forms and examples. Once finalized, these materials should be distributed to all staff in the SEC's Real Property Leasing Branch and other SEC staff with leasing-related responsibilities.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 5:

The Office of Administrative Services (OAS) should utilize the "Required Components" section of the Federal Real Property Council's (FRPC) Guidance for Improved Asset Management to develop and finalize the Security and Exchange Commission's (SEC) real property leasing asset management plan, as appropriate. If there are any required components

in the FRPC Guidance that OAS determines should not apply to the SEC, the plan should include an explanation as to why the SEC's unique circumstances render those components unnecessary.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 6:

The Office of Administrative Services should amend its leasing policies and procedures to require the tracking and monitoring of all leasing expenses (*i.e.*, rent, operating costs and taxes) for informational and budget formulation purposes.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 7:

The Office of Administrative Services (OAS) should develop performance goals for the Securities and Exchange Commission's real property leasing activities, including both lease acquisition and the monitoring and administration of existing leases; identify key factors external to OAS that could significantly affect the achievement of its performance goals; and periodically evaluate whether these goals are met.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 8:

The Office of Administrative Services (OAS) should develop performance measures to assist in evaluating the effectiveness of the major functions of real property acquisitions and operations, and periodically evaluate performance based on these measures. The performance measures should include metrics for all of the OAS Branches that have a role in real

property leasing, including the Real Property Leasing, Construction and Security Branches.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Finding 2: The Lack of Adequate Policies and Procedures Relating to the Renewal or Competition of Building Leases that Were Expiring Contributed to the Payment of Increased Rent for the San Francisco Regional Office Space

The lack of adequate policies and procedures contributed to the SEC incurring excess costs in connection with the leasing of space for the SEC's San Francisco Regional Office (SFRO).

As discussed in Finding 1 above, the SEC's policies and procedures for its leasing program are inadequate and incomplete. Our audit found that the failure to have adequate policies and procedures in place, specifically with respect to the planning for the competition or renewal of building leases that are due to expire, contributed to the SEC incurring significant increased costs in connection with its SFRO building lease.

The existing lease for the SFRO space at 44 Montgomery Street, San Francisco, under which the SEC paid rent at a rate of \$48.49 per rentable square foot (rsf), was due to expire on October 31, 2009.³² According to OAS, planning for a replacement lease began in July 2007, and an initial pre-solicitation notice published in December 10, 2007, yielded no expression of interest. Subsequently, OAS decided to negotiate a lease with the current landlord. OAS planned to extend the lease for 10 years and had "prepared a sole source justification for a succeeding lease, which was approved."³³

OAS stated, however, that between February and May 2009, the Leasing Branch was advised by its local broker and local occupants of dramatically falling rental

³² Justification for Other than Full and Open Competition, San Francisco, CA (SF Justification), signed on June 15, 2009 and approved on June 17, 2009, at p. 2.

³³ *Id.* at p. 1. According to OAS, the original justification for the succeeding lease was approved in March 2009, and contemplated a 10-year succeeding lease for \$49.46 per rsf.

rates in the San Francisco office market. On April 22, 2009, a Lead Realty Specialist within the Leasing Branch sent an email to OAS, SFRO and OGC colleagues, noting that a full and open competition should be conducted, instead of entering into a sole-source lease extension at 44 Montgomery Street.³⁴ Her email stated that OAS had “received more market information indicating a dramatic drop in rental rates in several high class office buildings.”³⁵ On April 24, 2009, OAS posted a presolicitation notice to the Federal Business Opportunities (FedBizOpps) website³⁶ for office space in San Francisco’s financial district. On May 12-14, 2009, OAS compiled a market survey of eight office properties in San Francisco. According to OAS, the SEC determined to pursue a full and open competition and several responses were received reflecting competitive opportunities.

On June 15, 2009, OAS completed a second justification for other than full and open competition document to extend the 44 Montgomery Street lease for only one year, or until October 31, 2010. In this justification, OAS stated that the one-year extension “will allow sufficient time to negotiate a long term solution.”³⁷ OAS indicated that the one-year extension was also intended to allow time to address security issues that had just been brought to OAS’s attention by the SFRO. The new justification stated that OAS expected to negotiate a price of approximately \$42.24 per rsf for the one-year extension.³⁸ Without the extension, the SEC would have to pay “holdover” rent of \$60.61 per rsf (125 percent of the current rent rate) if it occupied the 44 Montgomery Street site beyond October 31, 2009.³⁹ According to the justification, because the current lessor was under consideration for the succeeding lease, OAS believed the lessor would “be motivated to negotiate more favorable terms for the one[-]year extension.”⁴⁰ On July 13, 2009, the Lead Realty Specialist cancelled the previous sole source long-term lease procurement “[b]ased on new information regarding security concerns about unauthorized after-hours access and information that indicates the San Francisco market is declining by over 25% over last year”⁴¹ The Lead Realty Specialist indicated that OAS had “begun a full and open competition for a replacement lease.”⁴²

Almost three months later, on October 6, 2009, during the month in which the existing lease was due to expire, the SEC issued solicitations for offers (SFO) to four potential lessors.⁴³ By November 13, 2009, the SEC had received offers

³⁴ Email from Contracting Officer, re: SFRO lease procurement strategy, dated April 22, 2009.

³⁵ *Id.*

³⁶ <https://www.fbo.gov>.

³⁷ SF Justification, at p. 1.

³⁸ *Id.*

³⁹ *Id.* at p. 2.

⁴⁰ *Id.*

⁴¹ Memorandum for the File from Contracting Officer, Subject: Cancellation of Sole Source Procurement, dated July 13, 2009.

⁴² *Id.*

⁴³ According to OAS, in August 2009, the Leasing Branch received information from management about unanticipated staff increases and it became apparent that amount of space advertised and planned would

from 44 Montgomery Street (the existing home of SFRO) and two other offerors. The offers were then evaluated by a Source Selection Evaluation Board (SSEB), which consisted of three voting members (all SEC employees, two from OAS and one from SFRO) and seven technical advisors (with representatives from SFRO, OAS, the Office of General Counsel, an architectural firm, and a real estate broker). After reviewing the offers, the SSEB sent letters to all three offerors describing the strengths and weaknesses of their proposals. On February 1, 2010, the SSEB sent letters to the offerors requesting final proposals by February 12, 2010, which were received. On March 10, 2010, the SSEB issued a source selection report recommending an award to 44 Montgomery Street. On April 9, 2010, the SEC signed a new 10-year lease at 44 Montgomery Street with annual rent of \$41 per rsf, increasing by \$1 each year and providing for expansion of the existing office space. According to OAS staff, this lower rent rate does not commence until after construction of the 25th floor.

Meanwhile, the SEC's existing lease at 44 Montgomery Street had expired on October 31, 2009, and OAS had not executed the one-year lease extension to allow for more time until a new lease could be executed. OAS stated that while the SEC, through its broker, requested a one-year lease extension, the lessor demanded a three-year lease extension, and the SEC decided to allow the lease to go into holdover while pursuing competition for a long-term lease at a time when rates were low. As a consequence, as of November 1, 2009, the SEC began to pay holdover rent on 43,892 square feet of space,⁴⁴ rather than the \$42.24 per rsf the SEC expected to get in a one-year extension and the \$41 per rsf the SEC ultimately agreed to for the lease extension at 44 Montgomery Street. The SEC continued to pay rent at the higher holdover rate for approximately six months until it signed the new lease with 44 Montgomery Street on April 9, 2010. At that time, the SEC also entered into a Supplemental Lease Agreement with 44 Montgomery Street that modified the previous lease to extend the term and reduce the rental rate of the lease to the existing lease rate of \$53.34 per rsf, effective as of November 1, 2009.⁴⁵ The SEC is continuing to pay rent of \$53.34 per rsf until the new lower rent rate commences upon completion and acceptance of construction of the 25th floor. As a consequence, the failure to extend the previous lease prior to its expiration or to enter into a new one on a timely basis resulted in the SEC paying rent at rates higher than it would have paid had it executed the one-year lease extension contemplated by the second justification, during a downturn in the real estate market. We calculated that even with the credit obtained from 44 Montgomery Street, the SEC paid higher rent in the amount of approximately \$40,600 per month, or

no longer fully provide for the SEC's long-term needs, and a revised FedBiz Opps notice was published with no new eligible properties responding.

⁴⁴ While the second justification indicated that the holdover rent rate was \$60.61 per rsf, OAS staff indicated that holdover rent was paid at a rate of \$66.67 per rsf.

⁴⁵ As part of its February 12, 2010 offer for the new lease, 44 Montgomery Street had offered "to credit back the difference between the Holdover Rent amount and the new term lease rate at the commencement date." Proposal to Lease Space, SEC-SFRO-2010, dated February 12, 2010.

\$203,000 between November 1, 2009 and March 31, 2010. Thus, the OIG identified \$203,000 in questioned costs, as shown in Table 2, in Appendix VII.

According to OAS, “the lease procurement process can take anywhere from 18 to 24 months for approximately 30,000 to 60,000 square feet including the competition and build-out.”⁴⁶ With the SFRO lease, however, it appears that no efforts to recomplete the lease were begun until approximately six months before the existing lease was due to expire and it then took almost six months to issue the SFOs. Although OAS indicated that it performs acquisition planning⁴⁷ and SECR 11-03 and draft OP 11-03 require compliance with FAR § 7.104(c),⁴⁸ these documents do not adequately address acquisition planning. Significantly, the documents include no policies or procedures designed to ensure that appropriate planning occurs on a timely basis with respect to the SEC’s leases to avoid the types of delays and changes in approaches that occurred with respect to the SFRO lease. The documents contain no reference to FAR § 7.104(a), which provides that “[a]cquisition planning should begin as soon as the agency need is identified, preferably well in advance of the fiscal year in which contract award or order placement is necessary.”

Further, OAS’s policies and procedures include no requirement that Realty Specialists will seek the best value for the SEC in the planning, acquisition, and execution of real property lease agreements. Moreover, during our audit, we found that the Leasing Branch staff were not required to prepare project plans and did not, in fact, prepare them. An appropriate project plan would include various tasks necessary to complete the project, including obtaining timely lease extensions. The project plan could also include the estimated human resources and costs associated with each task.⁴⁹ The OIG notes that Attachment 1 to SECR 11-03 is a Leasing Acquisition Plan, which was first provided to the OIG on September 8, 2010. OAS should ensure that this document includes all the elements of an appropriate project plan and that a plan is required to be completed for each lease.

In summary, there were no sufficient policies or procedures in place to guide OAS staff to conduct appropriate acquisition planning, and inadequate planning contributed to increased costs on the part of the Commission. While OAS pointed out that changes in market conditions and agency requirements resulted in altered strategies, the OIG believes that improved policies and procedures for lease planning would better enable OAS to anticipate and react to potential changes in conditions or circumstances.

⁴⁶ Office of Administrative Services Update, Vol. 2: September 2009.

⁴⁷ “‘Acquisition planning’ means the process by which the efforts of all personnel responsible for an acquisition are coordinated and integrated through a comprehensive plan for fulfilling the agency need in a timely manner and at a reasonable cost. It includes developing the overall strategy for managing the acquisition.” FAR § 2.101.

⁴⁸ FAR § 7.104(c) requires the planner “coordinate with and secure the concurrence of the contracting officer in all acquisition planning. If the plan proposes using other than full and open competition when awarding a contract, the plan shall also be coordinated with the cognizant competition advocate.”

⁴⁹ FAR § 7.105 contains requirements for the contents of written acquisition plans.

Recommendation 9:

The Office of Administrative Services should revise Securities and Exchange Commission Regulation 11-03 and draft Operating Procedure 11-03 to include complete written policies and procedures for timely acquisition planning pertinent to real property leases. The revised policies and procedures should require the preparation of a project plan and schedule with projected dates for achieving various milestones well in advance of the scheduled commencement of a lease.

Management Comments. OAS concurred with this recommendation. See Appendix V for management’s full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Finding 3: The SEC Has Made and Continues to Make Simultaneous Payments for Two Properties in New York, One of Which the SEC Has Not Occupied for Several Years

The SEC entered into a “Wrap Around Lease and Surrender Agreement,” dated March 29, 2005, in order to terminate a lease for its New York Regional Office (NYRO) facility, which has resulted in the SEC making over \$15 million in payments for a property it no longer occupied. The SEC also entered into a second lease for its NYRO site and has been making simultaneous payments for the two facilities since May 2005, and will continue to do so until March 2012.

We reviewed a series of documents relating to two leases the SEC entered into for space for the NYRO to determine if the SEC’s lease requirements were appropriate and the agency was receiving the best value for its investment. These two leases included (1) A 10-year lease with 233 Broadway Owners LLC (the Woolworth Building) on September 27, 2001; and (2) A 15-year lease with Brookfield Financial Properties on March 25, 2005. Our audit showed that the following circumstances led to SEC simultaneously making payments for two buildings in New York City, only one of which was occupied by SEC staff.

Initial New York Lease – 233 Broadway Owners LLC. On September 27, 2001, the SEC entered into a lease with 233 Broadway Owners LLC (the Woolworth Building) on to serve as its NYRO location.⁵⁰ The SEC entered into

⁵⁰ Lease No. NYC-SEC-2001, dated September 27, 2001. At the time, the NYRO was referred to as the Northeast Regional Office.

this lease after its previous office space located at the World Trade Center was destroyed as a result of the September 11, 2001 terrorist attacks. According to OAS, the SEC acted very quickly to find new office space and, at the time, there was an unprecedented demand for office space in the New York City market.

Under the September 27, 2001 lease, the rentable area of the premises was 140,490 square feet, which included the entire eleventh, thirteenth, fourteenth, fifteenth, and sixteenth floors.⁵¹ The lease expiration date was 10 years and three months after the base rent commencement date (which was three months after the lease commencement date), subject to extension provisions.⁵² On April 9, 2002, the SEC elected to lease additional space, including the entire sixth floor of the building.⁵³ At that time, the expiration date of the lease was changed to March 31, 2012, subject to extension.⁵⁴ Under the terms of its lease and the amendments thereto, the SEC had the right to lease additional space in the building under certain circumstances.

Subsequently, however, the SEC discovered asbestos in the Woolworth Building and had a dispute with the landlord as to how the issue should be handled.⁵⁵ As a result of the dispute with the landlord, the SEC halted renovation work in its current space, and any serious discussions regarding expansion in the Woolworth building came to an end.⁵⁶ As noted below, the SEC decided to relocate its NYRO – a decision that, according to OAS, was made by senior agency management at a higher level than the leasing staff.

The lease included a clause on “Environmental Matters,” which defined asbestos as a hazardous material.⁵⁷ This clause further stated that the landlord shall indemnify, defend and hold the tenant harmless from any costs and expenses that arose at any time during or after the term of the lease as a result of or in connection with any hazardous materials present or occurring in the premises as a result of the activities or omissions of the landlord, its agents, employees or on-site contractors, including costs associated with the cleanup or removal of such hazardous materials.⁵⁸ The clause also required the landlord to “promptly take all actions, at its sole expense,” necessary to return the premises to their condition prior to the introduction of hazardous materials, with first obtaining the approval of the tenant (except in emergency situations).⁵⁹ If it was impossible to return the premises to such condition, the landlord could substitute an alternative

⁵¹ *Id.* at p. 7.

⁵² *Id.* at p. 12.

⁵³ First Amendment to Lease No. NYC-SEC-2001, dated April 9, 2002, at p. 1.

⁵⁴ *Id.* at p. 3.

⁵⁵ Justification and Approval for Other than Full and Open Competition Lease NYC-SEC-2004 (NYC Lease Justification), at p. 2.

⁵⁶ *Id.*

⁵⁷ Lease No. NYC-SEC-2001 at pp. 58-60.

⁵⁸ *Id.* at p. 59.

⁵⁹ *Id.* at p. 60.

action, if such alternative was acceptable to the tenant in its reasonable discretion.⁶⁰

Further, the lease included a clause that addressed default by the lessor. This clause provided that if the tenant could not reasonably conduct its business within the premises and actually ceased conducting business within the premises because the landlord failed to make any repair required under the lease, and this situation continued for more than five consecutive business days, all rent shall abate until the tenant re-entered the premises, or one day following the landlord's completion of the particular repair.⁶¹ However, the lease included no termination for convenience clause pursuant to FAR Part 49, which "establishes policies and procedures relating to the complete or partial termination of contracts for the convenience of the Government or for default" and "prescribes contract clauses relating to termination and excusable delay and includes instructions for using termination and settlement forms."⁶²

According to OGC staff, after the allegations of asbestos arose, asbestos tests were performed on the Woolworth Building. These tests revealed no asbestos dust in the air, but some asbestos in the wallboard. OGC staff indicated that the asbestos levels were not sufficient to warrant special procedures or to demonstrate that the landlord was in breach of contract.

Justification for and Entry into Second NYRO Lease (Brookfield Financial Properties). On April 28, 2004, SEC officials signed a "Justification and Approval for Other than Full and Open Competition" to obtain a new NYRO lease, "provided that the successor landlord assumes all the SEC's remaining obligations at the Woolworth Building, thus ending the SEC tenancy and all Government obligations there."⁶³ The justification indicated that the nature of the acquisition required use of the authority under FAR § 6.302-2, Unusual and Compelling Urgency,⁶⁴ and cited "two related components of such urgency and harm."⁶⁵ The first component was that the SEC did not have adequate space to accomplish its mission, given that operational workload had substantially increased and Congress had directed the SEC to hire additional staff (increasing NYRO staff from 311 to 395).⁶⁶ The second component was that the health and morale of SEC employees was negatively impacted by the above-mentioned discovery of asbestos that led to the dispute with the landlord and delays in any expansion of the work space.⁶⁷ The justification further asserted that the dispute

⁶⁰ *Id.*

⁶¹ *Id.* at p. 68.

⁶² FAR § 49.000.

⁶³ NYC Lease Justification, at p. 1.

⁶⁴ Under FAR § 6.302-2(a)(2), an agency may contract without providing for full and open competition "[w]hen 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 or sources from which it solicits bids or proposals"

⁶⁵ NYC Lease Justification at p. 2.

⁶⁶ *Id.*

⁶⁷ *Id.*

and delays “has led to significant reduction in NYRO staff morale, has hurt recruitment of new and additional staff, and has resulted in significant financial costs to protect SEC employees from potential asbestos excursions.”⁶⁸ The justification also asserted that the SEC and its NYRO employees were not confident that the asbestos problem could ever be fully resolved.⁶⁹

According to the justification, the SEC faced financial exposure of approximately \$63,205,000, flowing from its Woolworth Building lease obligations through April 2012.⁷⁰ The justification specifically included a requirement that “the successor landlord will assume all the SEC’s remaining obligation at the Woolworth Building.”⁷¹ The justification also noted that “even if the remaining costs of the current lease are not completely mitigated, or are only partially mitigated, the agency considers the costs appropriate to resolve the overcrowding, morale and intractable landlord reasons set forth above.”⁷²

On March 25, 2005, the SEC entered into a lease with Brookfield Financial Properties for 235,102 rsf. The lease did not require Brookfield Financial Properties to assume the SEC’s remaining obligation at the Woolworth Building, as the justification for the sole source award of this lease had indicated. However, under the terms of the lease, the payment of rent did not commence until approximately one-year later on April 1, 2006.⁷³ As a consequence, the SEC was responsible for paying operating expenses only during the first year of this lease. In addition, according to OAS, Brookfield Financial Properties offered rates that were lower than the rates remaining for the Woolworth Building lease.

Wrap Around Lease and Surrender Agreement. The SEC also contacted GSA, which found a tenant to move into the building. Accordingly, a “Wrap Around Lease and Surrender Agreement” was entered into with the Woolworth Building landlord (233 Broadway Owners LLC) on March 29, 2005.⁷⁴ Under the terms of this Agreement, the landlord agreed that the SEC’s previous lease would terminate, provided that the SEC made certain payments to the landlord, and the landlord and GSA executed a lease for the premises (the GSA Lease).⁷⁵ The Agreement also provided that the SEC would surrender a portion of the

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.* at p. 3.

⁷¹ *Id.*

⁷² *Id.*

⁷³ Lease No. SEC-NY-2005, dated March 25, 2005, at p.4.

⁷⁴ A “wrap around” lease is similar to a sublease. “In commercial real estate, a sublease is a lease (rental agreement) between a tenant who already holds a lease to a commercial space or property and someone (the sublessee) who wants to use part or all of the tenant’s space. In a sublease, the tenant assigns certain rights that they already hold to the leased property, to the sublessee.”

<http://womeninbusiness.about.com/od/commercialleasing/terms/g/sublease.htm>. “Sublessees pay rent directly to the rightful tenant (sublessor) to either share the space with the sublessor or take over the entire space from the sublessor.” *Id.* “A sub-lessor cannot legally assign rights in a sub-lessee that the sub-lessor does not also have rights to in their own lease. Additionally, a sublessor cannot sublease unless they are permitted to do so in their own lease.” *Id.*

⁷⁵ Wrap Around Lease and Surrender Agreement, dated March 29, 2005, at p. 1.

premises on May 31, 2005 (the “First Surrender Date”), and the remainder of the premises on June 30, 2005 (the “Second Surrender Date”).⁷⁶

In addition, the Wrap Around Lease and Surrender Agreement set forth in detail the amount of payments the SEC would make to the landlord under various scenarios, *i.e.*, if the GSA Lease was executed by the landlord and GSA; if the GSA Lease was renewed by GSA beyond the five-year lease term; and if the GSA Lease was extended beyond its original expiration date but expired or terminated prior to March 31, 2012, for any reason other than the Landlord’s default.⁷⁷ The Agreement also required the SEC, in addition to the foregoing payments, to pay “Work Contribution” of approximately \$5 million to be applied to tenant improvement expenses incurred by the landlord or GSA in connection with the GSA Lease.⁷⁸

Simultaneous Lease Payments. The SEC has made simultaneous payments related to New York leases since May 2005. Under the Wrap Around Lease and Surrender Agreement, the SEC has paid \$15,235,994.37 toward the Woolworth Building lease, even though no SEC employees have occupied that building since June 30, 2005. This amount was calculated based upon information provided by OFM for the period from the First Surrender Date of the Wrap Around Lease and Surrender Agreement (May 31, 2005) through the end of the period within our audit scope (March 31, 2010). During the same time period, according to the information provided by OFM, the SEC made payments to Brookfield Financial of \$35, 837,125.92 under the second lease. The SEC will continue to make partial payments toward the Woolworth Building lease until March 31, 2012.

The lack of SEC guidance for (1) evaluating options prior to vacating leased space or terminating a lease; and (2) including a termination for convenience clause or a broader, more inclusive default clause in a lease, or using flexible-lease terms, contributed to the SEC paying millions of dollars for space that it did not occupy. A more structured process for evaluating options prior to terminating lease may have led to another solution of the problems with the Woolworth Building lease that would have avoided duplicate lease payments. Additionally, the inclusion of a termination for convenience clause or a broader, more inclusive default clause in the lease, or the use of a shorter or flexible-term lease, would have provided the SEC with more options that would not have resulted in simultaneous lease payments being made for two office locations.

⁷⁶ *Id.*

⁷⁷ *Id.* at p. 2. GSA did execute a lease with the landlord. Subsequently, GSA exercised the lease renewal option at the Woolworth Building in July 2009, extending the lease through October 31, 2015, and no portion of the lease can be terminated earlier than in 2012. Email to SEC Contracting Officer from GSA Region 2 Special Projects Manager, Subject: GSA Lease GS-02B-23401, dated November 4, 2009.

⁷⁸ *Id.* at pp. 2-3.

Recommendation 10:

The Office of Administrative Services (OAS) should adopt evaluation procedures that involve scoring and ranking various options prior to deciding to vacate leased premises or to terminate a lease. OAS should develop a transparent methodology for how it formulates its scores and rankings, including an explanation of any numerical scores used to rank various options.

Management Comments. OAS concurred with this recommendation. See Appendix V for management’s full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 11:

The Office of Administrative Services, in consultation with the Office of General Counsel, should ensure that the Securities and Exchange Commission’s (SEC) real property leases provide appropriate protections in the event the SEC needs to terminate a lease before the expiration date, such as, for example, the use of a termination for convenience clause under Part 49 of the Federal Acquisition Regulation, another appropriate clause, or a flexible-term lease.

Management Comments. OAS concurred with this recommendation. See Appendix V for management’s full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Finding 4: Improved Coordination Is Needed Between the OAS Leasing and Security Branches to Ensure the Necessary Security Information Is Obtained Prior to Entering into a Lease

The Security and Safety Assessment document developed by the Security Branch requires improvement. Moreover, the failures to include a Building Security Survey with the solicitation for short-term lease in Alexandria, Virginia or to complete a Security and Safety Assessment resulted in the incurrence of additional costs to secure the facility.

The Interagency Security Committee (ISC)⁷⁹ releases security standards for government leased space. ISC standards are issued by the Department of Homeland Security and provide for four levels of security standards that are based on the number of government personnel occupying the space or the square footage leased. The OAS Security Branch provides advice to the Leasing Branch on safety, security, and emergency management for leased facilities. The final security requirements are negotiated by the Leasing Branch and the building owner. The specific security terms become a part of the lease and execution/completion of the terms are verified by the Security Branch prior to SEC employees occupying a building.

The Leasing Branch Chief and Security Branch Chief are relatively new OAS employees, both arriving in 2008. Our audit found that since that time, the two branches have been working hard to coordinate their efforts by developing security-related documents to be used in the real property leasing process. Two recently-developed documents currently in use by the two branches are the “Building Security Survey” and “Security and Safety Assessment.”

The Building Security Survey and Physical Security Review of Proposed Locations. For each real property lease, the Security Branch provides to the Leasing Branch a Building Security Survey, which becomes a part of the SFO. An offeror’s responses to Building Security Survey provide details on the current security posture of the proposed buildings. In addition, the survey presents the offeror the opportunity to include any proposed security improvements or enhancements.

After the offers have been received, the Leasing Branch sends the Security Branch a list of the buildings that are being considered for lease. The Security Branch then determines the threats located within 1,000 meters of the prospective locations. To determine the potential threats, the Security Branch staff works with national, state and local officials, including both civil and law enforcement components, to obtain information on the neighborhoods in which the prospective building sites are located. After the potential threats are determined, the Security Branch staff decides what countermeasures can be put into place to lessen the threats. Security Branch staff perform a physical review of each site, develop a report (the Security and Safety Assessment, see below), and provide a recommendation to the Leasing Branch as to what security measures should be implemented at the site.

The Security and Safety Assessment. The Security and Safety Assessment is a six-part document developed by the Security Branch. This document is

⁷⁹ “The ISC’s mandate is to enhance the quality and effectiveness of physical security in, and the protection of buildings and civilian federal facilities in the United States. The ISC standards apply to all civilian federal facilities in the United States—whether government-owned, leased or managed; to be constructed or modernized; or to be purchased.” http://www.dhs.gov/files/committees/gc_1194539370126.shtm.

designed to evaluate and, if warranted offer options to improve, the security posture of the facility.

Although the Security and Safety Assessment document includes some valuable information, our audit found that it could be improved. Parts 3 through 6 of the survey discuss the Security Branch's assessment of the potential lease site. Part 3 is an evaluation of threats and impact of loss based upon the Security Branch staff's interviews of law enforcement officials and review of crime databases to determine the threats to the local area surrounding the building. This section of the survey could be improved to include the number of recent incidents in the area and the likelihood that future incidents will occur. Part 4 is an evaluation of countermeasures and vulnerabilities. In the vulnerabilities section, the Security staff should include their best estimate of the likelihood that the identified vulnerabilities will be exploited. Part 5 pertains to risk management and discusses the recommendations to reduce identified risks. This section could be improved to include a recommendation for countermeasures based on the likelihood of occurrence of the identified vulnerabilities. Part 6 states the conclusions reached by the Security staff. This section should include a cost estimate for the security measures that will be required and could be developed by contacting agencies in the area with similar security measures. The Security Branch could also base its cost estimates on the actual security costs incurred for currently-occupied, similarly-sized SEC facilities. These additions to the survey will provide additional information that will be very helpful in conducting lease negotiations.⁸⁰

Extra Security Costs Incurred at Temporary Facility in Alexandria, Virginia.

On January 28, 2010, the SEC entered into a short-term lease⁸¹ with Cafferty-Shawnee L.L.C., for temporary space on the fourth floor of a building located in Alexandria, Virginia, to commence on March 1, 2010. According to OAS, the additional space was required because the SEC's existing Operations Center facility was at capacity. As far as building security was concerned, the lease agreement required the lessor to provide a guard station, which included a podium and two high chairs.⁸² The lease, however, did not require an armed guard to be stationed at the facility.⁸³ We also found that no Building Security

⁸⁰ The OIG acknowledges that some of the information to be included in the Security and Safety Assessment will be sensitive in nature, such that OAS may wish to ensure that the document is appropriately marked and stored to avoid any compromise of the SEC's security posture.

⁸¹ The lease was for a term of three years, with 18 months firm, beginning on March 1, 2010. Letter to the landlord from SEC Contracting Officer, dated January 28, 2010.

⁸² Lease No. SEC-AUXOPC-2010, dated January 28, 2010, at p. 2.

⁸³ A provision that the "[l]essor will be responsible for providing at the expense of the SEC and upon submission of proper invoice, an off duty armed police officer or Deputy Sheriff authority to carry a firearm and have the ability and equipment needed to react to an emergency security incident for a period of 12 hours per day," listed under "UNIQUE REQUIREMENTS," was crossed-out and initialed by the lessor and the government. *Id.* Similar provisions, some of which referred to the SEC bearing this expense, were crossed-out and initialed by the lessor and the government on SFO SEC-AUXOPC-2010, and Amendments 1 and 2 thereto. OAS explained that these provisions were crossed out because, at the time of the expedited lease action, the landlord was having difficulty obtaining confirmation from local authorities of the ability to obtain the services of an off duty police officer for the lease. Hence, according to OAS, the

Survey was included with the SFO for this lease and no Security and Safety Assessment was completed for this location. OAS indicated, however, that members of the OAS Security Branch participated in visits to the four potential sites identified by a pre-lease survey conducted on January 13, 2010.

OAS further stated that the SEC validated that there was a high crime threat in the area in which the leased temporary space was located. As a consequence, the SEC explored options for appropriately securing the SEC's leased space. It was determined that developing computerized access for this building would cost between \$300,000 and \$500,000, and that this would not be a cost-effective measure, given that the SEC had entered into a short-term lease. OAS decided that the most cost-effective option was to pay to have the landlord hire an off duty police officer (with permission from the local Chief of Police) at a cost of \$200,000 per year and to place unarmed guards on the floor occupied by the SEC at the SEC's expense. As a consequence, the SEC is currently paying for the full cost of an armed police officer at a facility where it is only occupying one of four floors. OAS noted that the other tenant in the building already has a security solution (*i.e.*, an electronic access system) in place.

OAS acknowledged that the Building Security Survey and the Security and Safety Assessment were not completed for the temporary space lease, noting that the finalized Building Security Checklist document and SFO paragraphs were agreed to and finalized by the Security and Leasing Branches in May 2010 (after the negotiation of the lease in question).⁸⁴ While OAS maintains that it is not clear that use of the forms would have resulted in cost savings, if the appropriate security documents had been utilized in connection with this lease, the Leasing Branch would have been better equipped to negotiate for adequate security of the facility to be provided as part of the initial lease document, rendering it unnecessary for the SEC to enter into a lease amendment requiring it to pay an additional amount for security at this location.

Recommendation 12:

The Office of Administrative Services should revise the Security and Safety Survey document to include more specific information, *i.e.*, the number of recent incidents in the vicinity and the likelihood of future incidents to occur, a best estimate of the likelihood of the identified vulnerabilities to be exploited, recommended countermeasures based on the likelihood of the identified events to occur, and cost estimates for recommended countermeasures.

requirement was eliminated from the lease until the details could be worked out between the SEC and the landlord. Pursuant to Supplemental Lease Agreement No. 2, dated March 30, 2010, the lessor agreed to provide an off duty armed police officer for 12 hours from Monday through Friday at an annual cost of \$200,000, to be paid monthly by the SEC.

⁸⁴ OAS further noted that in late April or early May 2010, the Security and Leasing Branches reached an agreement regarding how the branches would coordinate security-related activities in the leasing program, although it indicated that the two branches coordinated security prior to that time, *e.g.*, in February 2009.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 13:

The Office of Administrative Services should implement final policies and procedures to ensure that the Real Property Leasing Branch consistently includes the Building Security Survey document in all solicitations for officers for leased building space.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Recommendation 14:

The Office of Administrative Services should implement final policies and procedures to ensure that the Security Branch performs a physical review of prospective building locations and determines the threat within the immediate area prior to entering into a lease for any facility.

Management Comments. OAS concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OAS concurred with this recommendation.

Acronyms

AOs	Administrative Officers
FAC-C	Federal Acquisition Certification for Contracting
FAR	Federal Acquisition Regulation
FedBizOpps	Federal Business Opportunities
FY	Fiscal Year
FRPC	Federal Real Property Council
GSA	General Services Administration
GSAM	General Service Administration Acquisition Manual
ISC	Interagency Security Committee
NYRO	New York Regional Office
OAS	Office of Administrative Services
OFM	Office of Financial Management
OGC	Office of the General Counsel
OIG	Office of Inspector General
OIT	Office of Information Technology
OMB	Office of Management and Budget
OP	Operating Procedures
RCO	Realty Contracting Officer
rsf	Rentable Square Foot
SEC or Commission	U.S. Securities and Exchange Commission
SECR	Securities and Exchange Commission Regulation
SFO	Solicitation for Offer
SFRO	San Francisco Regional Office
SLA	Supplemental Lease Agreement
SPE	Senior Procurement Executive
SRPO	Senior Real Property Officer
SSEB	Source Selection Evaluation Board

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. 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 objectives. We determined that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope. The scope of the audit covered the period from January 2008 through March 2010, and included a review of any internal written policies and procedures for real property leasing and the relevant procurement documents.

Methodology. To determine if OAS established real property leasing policies and procedures and to determine if these policies and procedures were in compliance with applicable federal guidance and were consistently followed, the OIG obtained copies of all real property leasing policies and operating procedures (including drafts) from OAS, as well as copies of applicable federal laws, rules, and regulations that apply to real property leasing. We reviewed and compared the SEC's draft policies and procedures to the applicable federal guidance. In addition, for each new real property lease, we obtained copies of all documents used or developed during the procurement process, and analyzed and compared the documents received to documents listed in OAS's real property leasing *draft* policies and operating procedures. Further, we conducted interviews with SEC staff that have real property leasing responsibilities.

To ascertain how OAS maintains and tracks the SEC's real property leases, we identified the universe of the SEC's real property leases and inquired about the leasing staff's methods for managing, tracking, and maintaining oversight of leased properties. We also compared the staff's method of lease management to governing precedence.

To assess the lease requirements and determine if the SEC was receiving the best value for its investment, we utilized the universe of the SEC's real property leases noted above, selected a sample of leases to assess and obtained copies of all related, pertinent lease documents. We further interviewed the Leasing Branch Chief to determine if OAS had real property leasing performance measures to assess lease operations. We also interviewed the Security Branch Chief, obtained copies of the Security Branch's safety requirements, and determined the analysis performed by the Security Branch to develop the safety requirements recommended to the Leasing Branch.

Internal Controls. We assessed the internal controls and their significance in the context of our audit objectives by considering the following components:

- Identifying designated internal control officials for the entity subject to the audit, and determining their participation in the internal control program and their support for internal control objectives;
- Determining whether the audit area was included in a self-evaluation process;
- If management evaluated its performance regarding internal controls, using that evaluation as the basis for evaluating the adequacy of the self-evaluation process; and
- Determining the adequacy of management's self-evaluation.

The Internal Control Officer for OAS is the Associate Executive Director of OAS, who is responsible for ensuring that sound, economical and efficient internal controls are in place.

The OIG's review of internal controls determined that, at the time of the audit fieldwork, the SEC did not have any final internal policies and procedures governing its real property leasing procurement. SECR 11-03, *SEC Leasing Program*, which prescribes the policies and procedures governing the acquisition of leasehold interest in real property for the SEC was finalized and approved on or about August 31, 2010, after our audit fieldwork was conducted.

During our audit, we reviewed the draft internal policies and procedures pertaining to real property leasing that OAS provided and evaluated the adequacy and completeness of these documents. We found that OAS has not established performance measures to track lease performance, and there is no a uniform system/document for tracking leases.

Further, per Executive Order 13327, OAS should have an asset management plan. The OGC believes that SECR 11-03 satisfies this requirement. However, SECR 11-03 is missing many of the required components for an asset management plan set forth by the FRPC.

During an interview with OAS staff, it was determined that OAS does not have any leasing performance measures. OAS does not produce performance reports regarding individual leases. According to OAS, day-to-day performance monitoring is usually handled by regional office staff (AOs) because they are the first line of response to problems in tenant space and can directly access the building property manager for resolution of the types of issues that occur more frequently, such as with problems with utilities and maintenance. In addition, OAS staff indicated that there is no uniform collective management plan concerning the various leases.

During the audit entrance conference, OAS management was asked to provide copies of internal reports or assessments that were issued regarding real property leasing. OAS management responded that assessments were performed, but that they were not reflected in writing. Because any internal

control evaluations performed by management were not in writing, we were unable to determine the adequacy of any self-evaluation.

Use of Computer-Processed Data. We determined that the computer-generated data from the SEC's Momentum financial system could be relied on for the purposes of this audit.

Momentum is the one major system affecting real property leasing. Momentum serves as the SEC's financial accounting system and is used to track the agency's budget, obligations, expenditures and balances. The system owner is OFM.

The General Accountability Office (GAO) performs an annual audit of the SEC's financial statements. In the financial statement audit for Fiscal Years 2009 and 2008, GAO identified six significant deficiencies that collectively represented a material weakness in the effectiveness of internal controls over financial reporting.

To determine if the financial data from Momentum could be relied on, we performed an analysis of the amounts of lease payments authorized by OAS and the amounts actually recorded in Momentum. To perform the analysis, we obtained a computer-generated report from Momentum showing all monthly lease payments made from March 2008 through March 2010. From the report, we chose a sample of payments to verify. For the sample items selected, we obtained copies of the "Monthly Rental Voucher" (signed by the OAS COTR) and compared the amount authorized by OAS to the amount listed on the report. We did not identify any discrepancies between the amounts recorded in Momentum and the amounts authorized for payment by OAS.

Prior Audit Coverage. We reviewed SEC OIG and GAO reports relating to real property leasing to identify issues and risk areas. While all of the recommendations from the prior OIG Audit Report, No. 330, dated May 31, 2001, had been closed, we found that management had not, in fact, fully implemented the OIG's Recommendations B and E.

Recommendation B. "OGC should document its review of real property leases by including a memorandum in the leasing file." OAS stated that OGC reviews all lease actions and that the reviews are typically documented by email comments and approvals that are placed in the lease files. The OIG believes that, consistent with the prior recommendation, all lease files should contain documentation reflecting OGC review of the lease.

Recommendation E. "OAPM [now OAS] should provide the field offices with additional guidance and training on follow-up procedures for building maintenance services." OAS stated that

regional office AOs are issued delegation of Contracting Officer's Representative authority letters that spell out their responsibilities. However, OAS stated that it did not believe any further training was required for regional office leasing programs. The OIG believes that, consistent with the prior recommendation, OAS should explore possible training for regional office staff who have leasing responsibilities.

The OIG previously issued Report No. 471, *Audit of the Office of Acquisitions' Procurement and Contract Management Functions*, on September 25, 2009. Although this audit did not specifically concern real property leasing, the audit assessed the SEC's procurement and contract management processes and functions, which do impact leasing. Also, the same SEC office, OAS, oversees the agency's procurement and contracting and real estate leasing functions. Therefore, we reviewed the findings of audit report No. 471 and designed our audit objectives and audit steps to test for similar issues or risk areas in the area of real property leasing.

GAO's report on *Federal Real Property – Strategy Needed to Address Agencies Long-standing Reliance on Costly Leasing*, GAO-08-197 was issued in January 2008. To evaluate federal leasing trends and challenges, GAO analyzed data obtained from the Federal Real Property Council (FRPC) and OMB. GAO also examined ten federal leases (none of which were SEC leases) to determine the estimated cost of leasing versus the cost of new construction. In addition, GAO analyzed administrative and agency efforts to address long-standing problems in real property. Also in this report, GAO noted that, in January 2003, it had designated federal real property leasing as a high-risk area, citing the government's overreliance on costly leasing as one of the major reasons for this designation.

Although the GAO's report did not specifically address the SEC's leases or those of any other financial regulatory agency, we reviewed the GAO's findings and designed our audit objectives and audit steps to test for similar issues. The GAO's findings that we determined might be issues or risk areas at the SEC were:

1. Data quality remains a challenge.
2. Decisions to lease selected properties are not always driven by cost-effectiveness considerations.

Based on our analysis of the above listed SEC OIG and GAO reports, the following objectives were developed:

- Ascertain how the Real Property Leasing Branch maintains and tracks the SEC's real property leases.
- Identify current leases and assess whether the SEC lease requirements

are appropriate, and whether the SEC receives the best value for its investment.

Assessment of Audit Risk and Materiality. We assessed the audit risk and significance in the context of the audit objectives considering the following:

- Nature and profile of the program and the needs of users of the audit report.
- Internal controls as they relate to the specific audit objectives and scope of the audit.
- Legal and regulatory environment, and potential waste, fraud, and abuse in the context of the audit objectives.

Overall, our assessment concluded that the audit risk is high due to SEC's significant investment of funds in leased facilities and the lack of established real property leasing policies and procedures. At the time we performed our audit fieldwork, all of OAS's leasing policies and procedures were in draft form, and there were no final policies and procedures in place.

Criteria

Section 4(b)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78d(b)(3). Gives the SEC independent leasing authority and exempts it from GSA space management regulations or directives. Enacted by Public Law 101-550 on November 15, 1990.

House Conference Report No. 101-924, 101st Cong., 2nd Sess. (Oct. 23, 1990), reprinted in 1990 U.S.C.C.A.N. 3929. Contains the legislative history for Public Law 101-550, which provided the SEC with independent leasing authority.

Limitations on Expending and Obligating Amounts (Anti-Deficiency Act), 31 U.S.C. § 1341. Prohibits incurring commitments, obligations or expenditures in excess of amounts available for such purposes.

Section 601 of the Rural Development Act of 1972. Requires executive department and agencies to establish and maintain policies and procedures to give first priority to the location of new offices and facilities in rural areas. Enacted by Public Law 92-419 on August 30, 1972.

Federal Managers Financial Integrity Act of 1982. Requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control of each executive agency. Provides that the internal accounting and administrative controls of each executive agency should provide reasonable assurance that (1) obligations and cost comply with applicable law; (2) funds, property and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and (3) revenues and expenditures are properly accounted for and recorded. Enacted by Public Law 97-255 on September 8, 1982.

Executive Order 13327, Federal Real Property Asset Management. Contains guidance to promote the efficient and economical use of Federal real property resources, and requires that departments and agencies have asset management plans. Issued on February 4, 2004.

Executive Order 13006, Locating Federal Facilities on Historic Properties in Our Nation's Central Cities. Directs agencies, when operationally appropriate and economically prudent, to give first consideration to historic properties within historic districts when locating federal facilities. Issued on May 21, 1996.

Executive Order 12072, Federal Space Management. Provides that, except where otherwise prohibited, the process for meeting Federal space needs in urban areas shall give first consideration to centralized community business areas or adjacent areas of similar character. Issued on August 16, 1978.

Federal Acquisition Regulation (FAR), Title 48 of the Code of Federal Regulations. Contains the primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services with appropriated funds. Became effective on April 1, 1984, and was issued within applicable laws under the joint authorities of the Administrator of General Services, the Secretary of Defense, and the Administrator for the National Aeronautics and Space Administration, under the broad policy guidelines of the Administrator, Office of Federal Procurement Policy, OMB.

FAR Part 6 – Competition Requirements. Prescribes policies and procedures to promote full and open competition in the federal acquisition process, and provides for full and open competition, full and open competition after exclusion of sources, other than full and open competition, and competition advocates.

FAR Part 7 – Acquisition Planning. Prescribes policies and procedures for developing acquisition plans, among other things.

FAR Part 49 – Termination of Contracts. Establishes policies and procedures relating to the termination of contracts for the convenience of the government or for default. Prescribes contract clauses relating to termination and excusable delay.

OMB Circular A-11, Preparation, Submission, and Execution of the Budget, Part 2, Preparation and Submission of Budget Estimates. Sets forth the requirement for submitting budget estimates for all federal agencies. Section 33.1 of Part 2 pertains to estimates for construction, leases of capital assets and acquisition of real property. Issued in July 2010.

OMB Circular A-11, Preparation, Submission and Execution of the Budget, Part 8, Appendices, Appendix A, Scorekeeping Guidelines. Contains scorekeeping guidelines that are used by the House and Senate Budget Committees, the Congressional Budget Office, and OMB to measure compliance with pertinent statutes. Issued in July 2010.

OMB Circular A-11, Preparation, Submission and Execution of the Budget, Part 8, Appendices, Appendix B, Budgetary Treatment of Lease-Purchases and Leases of Capital Assets. Provides instructions on the budgetary treatment of lease-purchases and capital assets leases consistent with the scorekeeping rule developed by the executive and legislative branches in connection with the Budget Enforcement Act of 1990, as revised. Issued in July 2010.

OMB Circular A-94, Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs. Aims to promote efficient resource allocation through well-informed decision-making by the federal government. Provides general guidance for conducting benefit-cost and cost-effectiveness analyses, and specific guidance on discount rates to be used in evaluating federal

programs whose benefits and costs are distributed over time. Revised on October 29, 1992.

OMB Policy Letter 05-01. Establishes the government-wide framework for creating a federal acquisition workforce with the requisite skills. Defines the acquisition workforce to include individuals who perform various acquisition functions to support the accomplishment of the agency's mission. Prescribes the training requirements for members of the acquisition workforce.

Federal Real Property Council (FRPC) Guidance for Improved Asset Management. Addresses the FRPC guiding principles, required components for an agency asset management plan, property inventory data elements, and government-wide performance measures. Issued on December 22, 2004.

SECR 11-03, SEC Leasing Program. Prescribes the policies and procedures governing the acquisition of real property leasehold interests for the SEC. Provides that the SEC will adhere to all Executive Orders and legal requirement applicable to federal executive agencies acquiring leasehold interest in real property. Issued in August 2010.

SECR 10-02 (REV 2), SEC Contracting Authorities and Appointments. Establishes uniform policies and procedures for the acquisition of products and services for the SEC. Issued on March 31, 2010.

OP 11-03, SEC Leasing Program Operating Procedures (Draft). Provides guidance supplementing SECR 11-03, and details activities for acquisition and administration of leasehold interest in real property. Attaches lease checklists and guidance containing information and instructions the various tasks required during lease acquisition, design and construction phase and lease administration.

List of Recommendations

Recommendation 1:

The Office of Administrative Services (OAS) should revise Securities and Exchange Commission (SEC) Regulation 11-03 and draft Operating Procedure 11-03 (OP 11-03) to ensure that they are adequate and complete and include the information identified in the audit report, and should finalize OP 11-03 and the attachments thereto. OAS should ensure that the revised documents are posted to the Commission's Intranet site and that copies are circulated to all staff within the SEC's Real Property Leasing Branch, as well as other SEC staff with leasing-related responsibilities.

Recommendation 2:

The Office of Administrative Services should amend Securities and Exchange Commission (SEC) Regulation 11-03 to include a complete list of relevant authorities (federal statutes, regulations, executive orders, Office of Management and Budget circulars, and internal SEC policies) that apply to real property leasing and should finalize detailed guidance to ensure compliance with those authorities.

Recommendation 3:

The Office of Administrative Services should measure the Securities and Exchange Commission's real property leasing policies and procedures against pertinent provisions of General Services Administration (GSA) regulations, including the GSA Acquisition Manual and Subchapter C of the Federal Management Regulation, as appropriate.

Recommendation 4:

The Office of Administrative Services should ensure that the Leasing Branch's policies and procedures, including Operating Procedure 11-03 and the attached checklists, provide comprehensive guidance for Securities and Exchange Commission (SEC) leasing officials regarding the leasing process that will assist in ensuring compliance with the applicable policies, regulations and best practices. These materials should detail the regulations and policies that should be followed at the various stages of the leasing process and should include pertinent forms and examples. Once finalized, these materials should be distributed to all staff in the SEC's Real Property Leasing Branch and other SEC staff with leasing-related responsibilities.

Recommendation 5:

The Office of Administrative Services (OAS) should utilize the “Required Components” section of the Federal Real Property Council’s (FRPC) Guidance for Improved Asset Management to develop and finalize the Security and Exchange Commission’s (SEC) real property leasing asset management plan, as appropriate. If there are any required components in the FRPC Guidance that OAS determines should not apply to the SEC, the plan should include an explanation as to why the SEC’s unique circumstances render those components unnecessary.

Recommendation 6:

The Office of Administrative Services should amend its leasing policies and procedures to require the tracking and monitoring of all leasing expenses (*i.e.*, rent, operating costs and taxes) for informational and budget formulation purposes.

Recommendation 7:

The Office of Administrative Services (OAS) should develop performance goals for the Securities and Exchange Commission’s real property leasing activities, including both lease acquisition and the monitoring and administration of existing leases; identify key factors external to OAS that could significantly affect the achievement of its performance goals; and periodically evaluate whether these goals are met.

Recommendation 8:

The Office of Administrative Services (OAS) should develop performance measures to assist in evaluating the effectiveness of the major functions of real property acquisitions and operations, and periodically evaluate performance based on these measures. The performance measures should include metrics for all of the OAS Branches that have a role in real property leasing, including the Real Property Leasing, Construction and Security Branches.

Recommendation 9:

The Office of Administrative Services should revise Securities and Exchange Commission Regulation 11-03 and draft Operating Procedure 11-03 to include complete written policies and procedures for timely acquisition planning pertinent to real property leases. The revised policies and procedures should require the preparation of a project plan and schedule with projected dates for achieving various milestones well in advance of the scheduled commencement of a lease.

Recommendation 10:

The Office of Administrative Services (OAS) should adopt evaluation procedures that involve scoring and ranking various options prior to deciding to vacate leased premises or to terminate a lease. OAS should develop a transparent methodology for how it formulates its scores and rankings, including an explanation of any numerical scores used to rank various options.

Recommendation 11:

The Office of Administrative Services, in consultation with the Office of General Counsel, should ensure that the Securities and Exchange Commission's (SEC) real property leases provide appropriate protections in the event the SEC needs to terminate a lease before the expiration date, such as, for example, the use of a termination for convenience clause under Part 49 of the Federal Acquisition Regulation, another appropriate clause, or a flexible-term lease.

Recommendation 12:

The Office of Administrative Services should revise the Security and Safety Survey document to include more specific information, *i.e.*, the number of recent incidents in the vicinity and the likelihood of future incidents to occur, a best estimate of the likelihood of the identified vulnerabilities to be exploited, recommended countermeasures based on the likelihood of the identified events to occur, and cost estimates for recommended countermeasures.

Recommendation 13:

The Office of Administrative Services should implement final policies and procedures to ensure that the Real Property Leasing Branch consistently includes the Building Security Survey document in all solicitations for officers for leased building space.

Recommendation 14:

The Office of Administrative Services should implement final policies and procedures to ensure that the Security Branch performs a physical review of prospective building locations and determines the threat within the immediate area prior to entering into a lease for any facility.

Management's Comments

MEMORANDUM

September 28, 2010

TO: H. David Kotz
Inspector General

FROM: Sharon Sheehan 
Associate Executive Director
Office of Administrative Services

SUBJECT: OAS Management Response to Draft Report No. 484, *Real Property Leasing Procurement Process*

This memorandum is in response to the Office of Inspector General's Draft Report No. 484, *Real Property Leasing Procurement Process*. Thank you for the opportunity to review and respond to this report.

Cc: Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman
Diego Ruiz, Executive Director, Office of Executive Director
David Becker, General Counsel, Office of General Counsel
George Brown, Assistant Counsel, Office of General Counsel
John Branch, Assistant Director, Office of Administrative Services
Linda Sudhoff, Senior Program Analyst, Office of Administrative Services

Introduction

The Draft Audit Report (Report) reviews the SEC's leasing program. I believe the SEC's leasing program has been very successful. I appreciate the input from your audit staff, and look forward to further improvements to the leasing program with your Report in mind.

One of the main comments of the Report is that leasing policies and procedures could be improved. We agree that policies and procedures should always be improved. We will work to ensure that its policies and procedures properly document goals and requirements.

The Report also includes a focus on the SEC's New York Regional Office lease. As you know, the terrorist attacks of September 11, 2001 destroyed the SEC's New York office, which was located as part of the World Trade Center complex. We are extremely proud that, within three weeks of the tragic events of September 11, the SEC was able to reopen for business in lower Manhattan. The SEC was the first Federal agency to reopen in that area, and in so doing sent an important signal to the public and the investment community of the SEC's continuing regulatory presence and our commitment to this business center. As time passed after the move, it became apparent that problematic materials used to construct this older building was troublesome to staff morale, and that the space would not be able to accommodate future growth of the New York office. Thus, the SEC moved its operations to a larger location nearby and, in connection with GSA, transferred the old space to a different government tenant. The payments the SEC made to effect this move were, in our view, appropriate.

Another portion of the Report focuses on the leasing program's efforts to provide a succeeding lease for the SEC's San Francisco Regional Office. We believe that our efforts reflected appropriate management flexibility in response to changing market conditions and obtaining significant cost savings for the taxpayers.

Other findings in the Report address the importance of communication and coordination between the Leasing Branch and the Security Branch. We agree on the importance of effective coordination between these two branches. I believe improvements have been made, and we are committed to continuing to work to ensure their effective interaction.

The remainder of this memorandum addresses the specific findings and recommendations in the Report. Our leasing staff has also shared its more specific views with your office, and I will not repeat that information here.

Finding 1: The SEC's Leasing Policies and Procedures Are Inadequate and Incomplete.

The Report expresses concerns about the SEC's policies and procedures governing the SEC's real estate leasing program. As noted above, we agree that policies and procedures should always be improved, and will work to ensure that leasing policies and procedures properly

document goals and requirements. We think the leasing program overall has been a notable success.

Recommendation 1:

The Office of Administrative Services should revise Securities and Exchange Commission (SEC) Regulation 11-3 and draft Operating Procedure 11-03 (OP 11-03) to ensure that they are adequate and complete and include the information identified in the audit Report, and should finalize OP 11-03 and the attachments thereto. OAS should ensure that these revised documents are posted to the Commission's Intranet site and that copies are circulated to all staff within the SEC's Real Property Leasing Branch, as well as other SEC staff with leasing-related responsibilities.

We concur. The SEC finalized the SECR 11-03 and it is posted on the Intranet. Work is ongoing on the companion Leasing Program OP 11-03 and incorporated checklists, with plans to finalize and issue them in the near future. We will continue to work to improve the SECR and operating checklists consistent with governing authorities and responsible policies.

Recommendation 2:

The Office of Administrative Services should amend Securities and Exchange Commission (SEC) Regulation 11-3 to include a complete list of relevant authorities (federal statutes, regulations, executive orders, Office of Management and Budget circulars, and internal SEC policies) that apply to real property leasing and should finalize detailed guidance to ensure compliance with those authorities.

We concur. OAS agrees with the OIG that all relevant authorities and guidance should be included in SECR 11-03, OP 11-03, and incorporated and referenced guidance and checklists. We specifically note that OP 11-03, which is cited in SECR 11-03, cites a detailed list of relevant authorities including those specified in the Report. We agree with the OIG on the benefit and utility of checklists and detailed guidance for use by leasing personnel, and believe that such checklists and detailed guidance are best listed in operational desk guidance, where they can be continuously updated as needed, rather than in a formal SEC administrative regulation (SECR), which is not intended to be amended frequently. The drafting of OP 11-03 began with the corresponding GSA Lease File Checklist operational document, which GSA updates frequently. We are now working to finalize OP 11-03, which is currently a working document.

Recommendation 3:

The Office of Administrative Services should measure the Securities and Exchange Commission's real property leasing policies and procedures against pertinent provisions of General Services Administration (GSA) regulations, including the GSA Acquisition Manual and Subpart C of the Federal Management Regulation, as appropriate.

We concur. OAS agrees that GSA, as the leading Federal leasing activity, provides a significant precedent for any government leasing work. We agree that GSA practices frequently provide useful guidance for leasing decisions and the SEC routinely considers GSA practices, where appropriate, when undertaking leasing actions and developing regulations. Further, the Leasing Branch staff contains a strong cadre of experienced GSA professionals who bring that agency's institutional expertise to the SEC's independent authority. At the same time, as the OIG report acknowledges, the SEC has independent leasing authority, and is exempt from GSA space management regulations. The SEC was granted independent leasing authority so that, where necessary or appropriate, it could be different from GSA, and that the SEC would be able to exercise independent judgment on how best to achieve leasing value. While we cannot, therefore, promise that the SEC's own space management regulations will exactly track to GSA standards, we can assure you that we will continue to carefully assess all relevant GSA standards and guidance in order to incorporate those that are applicable and appropriate to the SEC's particular mission and authority.

Recommendation 4:

The Office of Administrative Services should ensure that the Leasing Branch's policies and procedures, including Operating Procedure 11-03 and the attached checklists, provide comprehensive guidance for Securities and Exchange Commission (SEC) leasing officials regarding the leasing process that will assist in ensuring compliance with the applicable, policies, regulations and best practices. These materials should detail the regulations and policies that should be followed at the various stages of the leasing process and should include pertinent forms and examples. Once finalized, these materials should be distributed to all staff in the SEC's Real Property Leasing Branch and other SEC staff with leasing-related responsibilities.

We concur. As discussed above in reference to Recommendation 2, OAS has and will continue to ensure that the OP 11-03 contains sufficient details, forms, examples to execute the leasing program. The SEC is finalizing the existing working draft OP 11-03 and its incorporated checklists. The Leasing Branch staff are familiar with the GSA checklist and routinely consider these lists during their work. Additionally, the Leasing Branch posts common Solicitations for Offers (SFO) documents on the OAS shared drive so branch members have access to templates and forms as revised for SEC acquisitions.

Recommendation 5:

The Office of Administrative Services (OAS) should utilize the "Required Components" section of the Federal Real Property Council's (FRPC's) Guidance for Improved Asset Management to develop and finalize the Security and Exchange Commission's (SEC's) real property leasing asset management plan, as appropriate. If there are any required components in the FRPC Guidance that OAS determines should not apply to the SEC, the

plan should include an explanation as to why the SEC's unique circumstances render those components unnecessary.

We concur. OAS agrees with the OIG on the importance of ensuring that asset evaluation, planning, and management is appropriately addressed in SECR 11-03, OP 11-03, and incorporated guidance and checklists. We also agree that there are elements of the FRPC's guidance that may be relevant and appropriate for the SEC to adopt. At the same time, we note that there may be limitations on the usefulness or applicability of this guidance to the SEC. First, the FRPC's guidance directive applies only to large cabinet-level agencies (so-called "CFO Act agencies"), and not to smaller agencies like the SEC, so the guidance is not generally tailored to the challenges facing a smaller agency such as the SEC. Finally, as a general matter, the SEC is not authorized to assume legal obligations that have not been imposed on it. Notwithstanding these notable limitations on the applicability of the FRPC guidance to the SEC, we have found the FRPC guidance's template for an agency's asset management plan to be valuable. The Leasing Branch routinely considers this as part of its regular duties to plan for, acquire, and manage the SEC's assets, and we will continue to ensure that asset evaluation, planning, and management are appropriately addressed in applicable SEC regulations and guidance.

Recommendation 6:

The Office of Administrative Services should amend its leasing policies and procedures to require the tracking and monitoring of all leasing expenses (i.e., rent, operating costs and taxes) for informational and budget formulation purposes.

We concur. We are pleased that the OIG did not identify any inappropriate payments or budget formulation problems relating to the leasing program, which offers evidence of the effectiveness of the Leasing Branch's efforts to accurately track expenses. Leasing costs in fully serviced leases (i.e., taxes, utilities, etc.) are generally bundled together in the SEC-adopted standard GSA Form 1217, and these costs are routinely compared and monitored during acquisition, negotiation and administration against industry norms. The Leasing Branch has worked with OFM to develop new budget object class (BOCs) codes for Momentum® and to further refine additional components of rent. The new BOCs will enhance the Leasing Branch's ability to track cost components and to formulate future budgets.

Recommendation 7:

The Office of Administrative Services (OAS) should develop performance goals for the Securities and Exchange Commission's real property leasing activities, including both lease acquisition and the monitoring and administration of existing leases, and identify key factors external to OAS that could significantly affect the achievement of its performance goals, and should periodically evaluate whether these goals are met.

We concur. OAS plans to develop appropriate performance goals for the real property leasing program. As a general matter, we note that OAS has established general performance goals and measures, which are evaluated throughout the year, for instance through OAS's annual submittals to the SEC's Performance and Accountability Report and its management assurance on internal controls statements.

Recommendation 8:

The Office of Administrative Services (OAS) should develop performance measures to assist in evaluating the effectiveness of the major functions of real property acquisitions and operations, and should periodically evaluate performance based on these measures. The performance measures should include metrics for all of the OAS Branches that have a role in real property leasing, including the Real Property Leasing, Construction and Security Branches.

We concur. OAS plans to develop appropriate performance metrics for the real property leasing program. As a general matter, we note that OAS has established general performance goals and measures, which are evaluated throughout the year, for instance through OAS's annual submittals to the SEC's Performance and Accountability Report and its management assurance on internal controls statements.

Finding 2: The Lack of Adequate Policies and Procedures Relating to the Renewal or Competition of Building Leases that Were Expiring Contributed to the Payment of Increased Rent for the San Francisco Regional Office Space.

We appreciate having the opportunity to comment on this portion of the Report, which focused on the leasing of space for the SEC's San Francisco Regional Office (SFRO).

Overall, we believe that the SFRO lease delivered significant benefits for the agency. The significant decline in commercial office space rental rates in San Francisco created a cost savings opportunity. As circumstances changed, the leasing program adjusted and abandoned its current extension plans in favor of competition. We did attempt to negotiate a short-term extension at a more affordable rate, but the landlord did not accept our proposals. As a result, the agency was forced to make a business judgment to carry the lease into holdover while we conducted a full and open competition.

The results of that competition are now complete, and we strongly believe that we achieved good value and terms for the SEC. Specifically, the agency moved from an expiring lease rate of \$53/per rentable square foot (prsf) rate to a ten-year average rate of \$45.50/prsf with more tenant improvement (TI) allowance, tenant credits and zero per cent amortization. We also negotiated a rental rate that was more than \$1.8 million less than the next low offeror, a significant savings to taxpayers. While we acknowledge that there were costs associated with

continuing the existing rental rate to provide time for the benefits of competition to be realized, these costs were, on the whole, modest and will be fully recovered through the succeeding lease.

Recommendation 9:

The Office of Administrative Services should revise Securities and Exchange Commission Regulation 11-3 and draft Operating Procedure 11-03 to include complete written policies and procedures for timely acquisition planning pertinent to real property leases. The revised policies and procedures should require the preparation of a project plan and schedule with projected dates for achieving various milestones well in advance of the scheduled commencement of the lease.

We concur. These policies and procedures are substantially in place and we will continue to improve them with the audit recommendation in mind.

Finding 3: The SEC Has Made and Continues to Make Simultaneous Lease Payments for Two Properties in New York, One of Which the SEC Has Not Occupied for Several Years.

As noted above, the SEC is proud that after the tragic events of September 11th, which destroyed its New York offices, the SEC was able within three weeks to reopen for business in lower Manhattan. It subsequently became apparent that problematic materials used to construct this older building was troublesome to staff morale, and that the space would not be able to accommodate future growth of the New York office. Thus, the SEC moved its operations to a larger location nearby and, in connection with GSA, transferred the old space to a different government tenant. The payments the SEC made to effect this move were, in our view, appropriate. The cost of the old space is shared by two federal agencies, the SEC and GSA, at no additional cost to the taxpayer.

Recommendation 10:

The Office of Administrative Services (OAS) should adopt evaluation procedures that involve scoring and ranking various options prior to deciding to vacate leased premises or to terminate a lease. OAS should develop a transparent methodology for how it formulates its scores and rankings, including an explanation of any numerical scores used to rank various options.

We concur. Given the special circumstances that resulted from the 9/11 terrorist attacks, both senior management and Congressional staff were briefed by the leasing program on the potential cost of moving the NYRO space and other pros and cons before the decision was taken. While our experience—and hope—is that it will be extremely rare for a federal agency to leave a lease prior to its expiration or firm term, OAS recognizes the importance of a good planning

process to help mitigate such risks. We will consider as recommended the use of rankings and scores of various options should such scenarios arise in the future.

Recommendation 11:

The Office of Administrative Services, in consultation with the Office of General Counsel, should ensure that the Securities and Exchange Commission's (SEC) real property leases provide appropriate protections in the event the SEC needs to terminate a lease before the expiration date, such as, for example, the use of a termination for convenience clause under Part 49 of the Federal Acquisition Regulation, or another appropriate clause, or a flexible-term lease.

We concur. As noted in the response to Recommendation 10, it is extremely rare for a federal agency to leave a lease prior to its expiration or firm term. We will work with OGC to ensure that as favorable clauses as possible are included in SEC leases, and to consider GSA practices and clauses on termination and default. We note that the SEC has sought and obtained flexibility over lease terms through substitution of agency clauses that are in several SEC leases, and that the headquarters lease provides that the SEC can assign certain amounts of space to a high quality government associated tenant and be relieved of its lease obligations for that assigned space.

We will also continue to explore other options, including whether termination for convenience clauses would be appropriate for leases. As a general matter, GSA and private sector practice does not include convenience termination and other early no-fault termination clauses in office space leases. This is because leases, unlike other contracts, can last for many years, frequently 10 to 15 years, and often require significant construction and renovation of buildings, which in turn requires financing. Because a termination for convenience clause in effect converts a long-term lease into a lease that can be terminated at will, we are not aware of lenders who will provide financing for a building where a tenant can terminate for convenience, as such a termination would interrupt the repayment of their loan.

Finding 4: Improved Coordination Is Needed Between the OAS Leasing and Security Branches to Ensure the Necessary Security Information Is Obtained Prior to Entering into a Lease.

We appreciate having the opportunity to comment on this portion of the Report, which focused on the leasing of a temporary facility in Alexandria, Virginia to accommodate growth that could not be accommodated at the SEC's nearby Operations Center (OPC). Members of the Leasing, Construction, and Security Branches and the Office of Information Technology (OIT), as well as senior OAS management, participated in the visits to all viable sites.

As the Report notes, the physical security of this temporary facility was a key area of focus for the agency. The agency ultimately decided that the most cost-effective solution,

especially given the temporary nature of the lease, was to provide unarmed guards and one off-duty armed police officer (ODPO) instead of installing and maintaining an electronic access system. At the SEC, the security and safety of our employees and contractors are paramount concerns. Because the Leasing Branch does not make security decisions for a leased location, and must work with the Security Branch for the incorporation of the appropriate security countermeasures for that location/building, OAS agrees on the importance of ensuring timely and effective communication and coordination between these two branches particularly with respect to urgent acquisitions.

Recommendation 12:

The Office of Administrative Services should revise the Security and Safety Survey document to include more specific information, *i.e.*, the number of recent incidents in the vicinity and the likelihood of future incidents to occur, a best estimate of the likelihood of the identified vulnerabilities to be exploited, recommended countermeasures based on the likelihood of the identified events to occur, and cost estimates for recommended countermeasures.

We concur. We will ensure that this Safety and Security Assessment document, which often reveals sources and methods, is marked and stored appropriately to prevent the content from entering the public domain, thus ensuring that our security posture is not compromised. Copies will not be shared outside appropriate Government entities or contractors.

Recommendation 13:

The Office of Administrative Services should implement final policies and procedures to ensure that the Real Property Leasing Branch consistently includes the Building Security Survey document in all solicitations for officers for leased building space.

We concur. OAS plans to take action shortly to issue final policies and procedures. In the meantime, we wish to reassure you that the Leasing Branch has been utilizing all functions of the draft procedures in their day-to-day leasing program responsibilities.

Recommendation 14:

The Office of Administrative Services should implement final policies and procedures to ensure that the Security Branch performs a physical review of the prospective building location and determines the threat within the immediate area prior to entering into a lease for any facility.

We concur. Using the finalized Building Security Survey document and SFO paragraphs agreed to and finalized by the Security and Leasing Branches in May 2010, the draft OP 11-03 will be updated to reflect the timing and performance of the related security and lease acquisition tasks.

Appendix II.

The Report also suggested several actions that could be taken to strengthen previous SEC actions taken in response to a 2001 OIG audit report (Report #330, May 31, 2001).

Recommendation B : OGC should document its review of real property leases by including a memorandum in the leasing file. The OIG believes that all lease files should contain documentation reflecting OGC review of the lease.

We concur. OGC reviews all lease actions, and reviews numerous stages of the leasing process, as found in the Lease File Checklist and associated guidance, to include advertisements, SFOs, SSEB decisions, etc. The reviews are typically documented via emailed comments and approvals and the records are placed in the lease files. To address the recommendation, OAS Leasing Branch will add to its checklist a request from OGC at the time of lease award to note its review by email to the leasing specialist who will put the email in the official file.

Recommendation E: OAPM [now OAS] should provide the field offices with additional guidance and training on follow-up procedures for building maintenance services.

We concur. While the Report does not identify any specific instances of problems existing in the regional offices, OAS will provide additional training for the leasing program in the regions. In the regional offices, Administrative Contacts are issued delegation-of-COR-authority letters by the Lease Contracting Officer, which spells out their responsibilities. They are not permitted to make leasing decisions, but instead are directed to report building management issues to the building Property Managers and bring any leasing issues to the attention of the Contracting Officer. To address the recommendation, OAS will provide training at the annual Administrative Contacts conferences, where leasing issues and best practices are among topics discussed, and will consider other training opportunities, as appropriate, for the regional Administrative Contacts, as well as maintain open communication with them during site visits and daily interactions.

OIG Response to Management's Comments

The Office of Inspector General is pleased that the OAS has concurred with all of the report's 14 recommendations. We appreciate OAS's commitment to improving the policies, procedures and processes pertaining to real property leasing. We believe that the implementation of the OIG's recommendations will result in significant improvements to the SEC's real property leasing program and will ensure, consistent with the intent of Congress in providing the SEC with independent leasing authority, that the SEC exercises that authority vigorously to achieve cost savings and increase the Commission's productivity and efficiency.

Schedule of Questioned Costs

Table 2. Questioned Costs Relating to Excess Rent

Questioned Costs	
Excess rent paid for 44 Montgomery Street (* \$40,600 x 5 months)	\$203,000*
Total	\$203,000

Source: OIG Generated

Audit Requests and Ideas

The Office of Inspector General welcomes your input. If you would like to request an audit in the future or have an audit idea, please contact us at:

U.S. Securities and Exchange Commission
Office of Inspector General
Attn: Assistant Inspector General, Audits (Audit Requests/Ideas)
100 F Street, N.E.
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Hotline

To report fraud, waste, abuse, and mismanagement at SEC,
contact the Office of Inspector General at:

Phone: 877.442.0854

Web-Based Hotline Complaint Form:
www.reportlineweb.com/sec_oig