



File  
Copy

096671

COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

238.10

FEB 14 1972

72-11296



B-114874

R Dear Mrs. Abzug:

Your letter of December 1, 1971, requested that our Office analyze the material furnished to you by the Postal Service regarding two proposals for obtaining a vehicle maintenance facility (VMF) in New York City.

7  
52  
19  
28

The proposals concerned the question of whether the Postal Service should (1) construct for ownership a VMF on land owned by the Postal Service adjacent to the Morgan Postal Station (Morgan Annex site) or (2) negotiate to lease a similar VMF to be constructed by Sharp Development Corporation on land about 2 city blocks from the Morgan Annex site.

Postal Service representatives informed us that their cost analysis was prepared in 1 day at the request of the Service's Board of Governors. Therefore the data was preliminary and items of estimated Government ownership costs were not supported by adequate detailed information.

A representative of the Sharp organization told us that, after its lease proposal was made about a year earlier, construction costs had risen sharply; therefore such increased costs would have to be considered in any formal agreement made with the Postal Service.

Your office agreed that, because of the lack of supporting data for the Postal Service cost estimates and the time constraints for reporting to you, the information furnished by the Postal Service need not be verified. On the basis of available data, our comparative cost analysis shows that it would be more economical for the Postal Service to construct for ownership a VMF on the Morgan Annex site.

In our analysis, we have stated costs in terms of the current purchasing power of the dollar and we have discounted future costs and receipts to state them in terms of their present value. In contrast, the costs shown by the Postal Service are actual dollar flows expected over a 20-year period.

~~700959~~

1096671

BEST DOCUMENT AVAILABLE

## BEST DOCUMENT AVAILABLE

The following table shows our comparison of estimated alternative costs using the discounting method.

Comparison of Alternative Estimated Costs

	Postal Service estimated cost <u>totals</u>	GAO-adjusted cost estimates-- <u>present value</u>
Government ownership costs (Morgan Annex site):		
Land	\$ 9,600,000	\$ 9,600,000
Sale of air rights	-4,000,000	-3,738,000
Building	20,787,000	19,572,000
Residual value of land and building	<u>-21,296,000</u>	<u>-2,347,000</u>
Estimated Government ownership costs	<u>5,091,000</u>	<u>23,087,000</u>
Leasing costs (Sharp proposal):		
Lease payments	63,860,000	21,416,000
Purchase of lease prop- erty and profit on subsequent sale	-4,691,000	-517,000
Travel costs to Morgan Station	<u>14,360,000</u>	<u>4,337,000</u>
Estimated leasing costs	<u>73,529,000</u>	<u>25,236,000</u>
Difference in favor of Government ownership	<u>\$68,438,000</u>	<u>\$ 2,149,000</u>

The comparison does not include certain other costs which would be the same under both alternatives and therefore would not affect the result. Such costs include acquisition and maintenance of equipment, fuel stations, and facilities for washing vehicles.

In converting future costs to present value, we used a discount rate of 7 percent which represented the annual interest rate of 6-7/8 percent payable on the 25-year Postal Service bonds issued in January 1972 plus the fee paid underwriters for issuing the bonds.

An explanation of the items included in our comparative cost analysis follows.

#### GOVERNMENT OWNERSHIP COSTS

##### Land

The Postal Service estimated the current market value of the Government-owned Morgan Annex site (29th Street property) at \$60 a square foot, or a total of \$9.6 million. Postal Service officials informed us that their estimate of current market value was based on estimates of property values in the area of the Morgan Annex provided by Corps of Engineers real estate officials and a commercial building contractor in New York City. The Corps of Engineers is responsible for the <sup>305</sup> Postal Service facilities construction program.

##### Air rights

The Postal Service estimated that the air rights above VMF could be sold for \$4 million. Housing units could be constructed on top of VMF. The Postal Service explained that this sales price was a "very preliminary estimate" that represented the costs of designing and constructing the foundation and superstructure of VMF so that it would support housing units.

##### Building

The Postal Service estimated that the construction cost of the VMF portion of the 24-story building would be \$20,787,000. The estimate was based on a rate of \$30 a square foot for 620,000 square feet plus architect-engineer fees and fees to the Corps of Engineers.

## BEST DOCUMENT AVAILABLE

B-114874

The Postal Service stated that the construction cost estimate was only approximate and was not the result of an engineering survey. Postal Service officials said that the estimate was based on an analysis of recent construction costs of other postal facilities in the New York City area and the combined judgment of various knowledgeable Postal officials. The Corps of Engineers is developing a construction cost estimate for use in soliciting and evaluating construction contract proposals.

### Residual value of land and buildings

The Postal Service estimate of residual value consists of \$3,078,000 for the land and \$18,218,000 for the building, or a total of \$21,296,000. In computing the residual value of the land, the Postal Service assumed that, after sale of air rights, its share would be 10 percent of the land which had a market value of \$9.6 million. Therefore the Postal Service assumed the market value of this portion to be \$960,000. This amount was increased for inflation and real-value appreciation at the rate of 6 percent a year for 20 years for a total value of \$3,078,000.

Postal Service officials advised us that the 6-percent rate was developed with assistance from the Office of Management and Budget and commercial real estate firms. The officials did not specify separate rates for inflation and appreciation, but we assumed that, on the basis of the 4-percent inflation rate used in the Postal Service estimates, the 6-percent rate included 4 percent for inflation and 2 percent for appreciation in land value. We eliminated the 4-percent inflation rate so that the dollar cost in our analysis was stated in terms of the current purchasing power of the dollar. We included the 2-percent appreciation in land value because it represents the effect of the scarcity of land and, therefore, it shows the real-value increase.

In our analysis we did not adjust the Postal Service estimates relating to the value of the Morgan Annex land. Increasing the value of the air rights or the residual value of the land would not alter our conclusion that it would be more

## BEST DOCUMENT AVAILABLE

desirable to own than to lease VMF because such an increase would make the difference in favor of ownership greater.

In computing the residual value of the building, the Postal Service assumed that the total cost of the building (\$20,787,000) would be depreciated 60 percent or would have a residual value of \$8,315,000 at the end of 20 years. This amount was inflated by 4 percent a year for the same period, a total of \$9,903,000. Thus the estimated residual value of the building at the end of 20 years would total \$18,218,000.

In our computation we eliminated the inflation factor from the building cost estimate. Although we do not agree with the Postal Service's assumption that the building will be depreciated 60 percent at the end of 20 years, any adjustment that we might make in our computation would not alter our conclusion.

ESTIMATED COST OF LEASINGLease payments

Annual lease payments of \$3,193,000, which would total \$63.9 million for the 20-year lease period, were based on the Sharp Development Corporation proposal of \$5.15 a square foot for a requirement of 620,000 square feet for the postal facility.

For consistency with our treatment of an annual inflation rate of 4 percent under the Government ownership alternative, we eliminated the annual inflation rate of 4 percent for lease payments, or a total of about \$10 million. We also converted future costs to their present value by using a 7-percent discount rate which was also used to convert Government costs to present value. The effect of discounting was to reduce total lease costs by about \$32 million.

Purchase of lease property and profit on sale

The Postal Service assumed that, in accordance with common leasing practice, it would have an option to purchase the

leased property at the end of 20 years for 110 percent of the original cost. Under these circumstances, the Postal Service estimated that it could acquire the property--both land and building having a market value of about \$29.8 million--for about \$25.1 million. The Postal Service considered the difference of \$4.7 million to be a gain and correspondingly reduced the cost of the lease alternative.

The Postal Service estimate of market value of the leased property was based on the same rate used in estimating the value of the property under the Government ownership alternative--\$60 a square foot for land and \$30 a square foot for the building. Similarly the residual value of the leased building was based on the same assumption used under Government ownership--the building would be depreciated 60 percent at the end of 20 years.

#### Travel cost to Morgan Station

The location of the proposed lease site is about 2 city blocks from the alternative Government-owned Morgan Annex site. Because most of the Postal Service vehicles which would be parked at the lease site would operate out of or travel past the Morgan Postal Station (adjacent to the alternate Morgan Annex site), the Postal Service added to the cost of the lease alternative an estimate of the additional vehicle operating costs for travel between the two proposed VMF sites.

#### State and local real estate taxes

Property owned by the Federal Government is not subject to State and local real estate taxes. In making cost comparisons, to determine whether the Government should buy or lease property--lessors usually have to pay State and local real estate taxes--we believe that it is appropriate to recognize as a cost of Government ownership real estate taxes which are foregone by States and localities when the Government buys privately owned property.

In the instant case, however, we did not add State and local taxes to the Government ownership costs because the

BEST DOCUMENT AVAILABLE

lease proposal from Sharp submitted to the Postal Service in April 1970 stated that annual lease payments did not include an allowance for taxes and that the taxes would be the responsibility of the tenant (Postal Service). Since the costs of leasing did not include taxes, it would not be necessary to add taxes to the Government ownership alternative costs to make the two analyses comparable.

In a letter dated December 21, 1971, the firm that is handling the Sharp proposal stated that the Postal Service could consider for its guidance that the lease rate included a provision for the payment of taxes. The firm, however, qualified this statement as follows:

- "1. The question of taxes vis-a-vis the \$5.15 rate is somewhat academic and can only be considered in terms of the total development costs that existed at the time of the proposal and which was almost one year ago.
- "2. The subject of taxes is not an altogether clear one when land is being developed for use by an essentially tax exempt lessee;\*\*\*."

We discussed the matter of taxes with Postal Service officials who stated that postal leases have separate provisions for taxes which are not included as part of the rental because of the uncertainties of future tax rates. These officials were also of the opinion that, if the Postal Service were negotiating for leasing, the lease rate would be increased because they believed that the proposed lease rate did not include a factor for taxes.

We have not requested the Postal Service or the real estate firm to review or comment formally on the information in this report. We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been

B-114874

obtained or public announcement has been made by you concerning the contents of this report.

We trust this information will be helpful.

Sincerely yours,

Handwritten signature of E. A. Morse, Jr. in cursive script.

For the Comptroller General  
of the United States

*alt* The Honorable Bella S. Abzug  
*R* House of Representatives

BEST DOCUMENT AVAILABLE