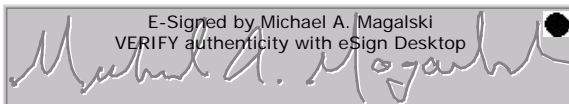




February 12, 2014

MEMORANDUM FOR: TOM A. SAMRA
VICE PRESIDENT, FACILITIES

E-Signed by Michael A. Magalski
VERIFY authenticity with eSign Desktop


FROM: Michael A. Magalski
Deputy Assistant Inspector General
for Support Operations

SUBJECT: Management Alert – Risks Associated With
CB Richard Ellis, Inc. Contract
(Report Number SM-MA-14-003)

This management alert presents potential financial risks associated with the U.S. Postal Service's real estate management services contract with CB Richard Ellis, Inc. (Project Number 12YG018DA001).

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

Attachment

cc: Corporate Audit and Response Management

Introduction

The U.S. Postal Service awarded a contract in June 2011 to CB Richard Ellis, Inc. (CBRE) to be the sole provider of Postal Service real estate management services. The Postal Service believed that leveraging the capabilities of a national real estate firm would allow for a more effective use of limited resources. As the largest real estate owner in the world, CBRE has one of the broadest industry platforms. In 2012, CBRE was responsible for more than \$189.8 billion in property sales and lease transactions globally and managed more than 3.3 billion square feet of commercial properties and corporate facilities.

The U.S. Postal Service Office of Inspector General (OIG) completed an audit in June 2013 of the Postal Service's real estate management services contract with CBRE.¹ We concluded that Postal Service Facilities officials should improve oversight of the CBRE contract to mitigate inherent risks and conflict of interest concerns.² In response to our recommendations, management implemented a maximum contract amount and appointed contracting officer's representatives to monitor contract performance and approve payments.

Because of the urgency and sensitivity associated with CBRE contract control weaknesses, we are issuing this alert to make the Postal Service aware of the need to further modify the CBRE contract.

Conclusion

As a result of our audit and ongoing concerns surrounding the CBRE contract, we have identified additional information that increases the financial risks to the Postal Service. Specifically, Postal Service officials modified the contract in June 2012 to allow CBRE to negotiate on behalf of the Postal Service as well as prospective buyers and lessors in the same real estate transaction. Also, CBRE was responsible for soliciting appraisals to determine the fair market value of the properties that it then sells and leases.

The contract modification also requires CBRE to notify the Postal Service of any actual or potential conflicts of interest, such as owning or having an interest in a property that may be part of a Postal Service real estate transaction. To date, CBRE has not notified the Postal Service of any such conflicts. Given the multiple roles CBRE plays within the real estate industry, the Postal Service should take steps to lessen the potential for CBRE to engage in transactions that create conflicts of interest. CBRE conflicts of

¹ *Contracting of Real Estate Management Services* (Report Number [SM-AR-13-001](#), dated June 12, 2013).

² Conflict of interest concerns existed because the contractor provided a range of property values to negotiate a lease and then received a commission from the lessor based on the property value negotiated. Further, the Postal Service paid the contractor to act on its behalf in negotiating leases and the contractor could also represent the lessor.

interest could lead to financial loss to the Postal Service and decrease public trust in the Postal Service's brand.

Contract Modification

Initially, Postal Service officials contracted with CBRE to represent the exclusive interests of the Postal Service. However, they modified the contract on June 28, 2012, to allow dual agency representation, in which CBRE represents the Postal Service and prospective buyers and lessors. Officials stated that dual agency representation is a commercially acceptable real estate practice. They further noted that these types of practices arose while CBRE provided real estate management services to the Postal Service. However, the initial contract did not specifically allow for dual agency representations, and as a result, the contract was modified.

The contract modification requires CBRE to notify the Postal Service of any actual or potential conflicts of interest within 5 days of any request for or ordering of contract work. CBRE has submitted 10 dual agency disclosure letters detailing transactions in which it represented both the Postal Service and potential buyers or lessors. CBRE potentially violated the initial contract by representing both parties in three of these transactions before the contract was modified to allow for dual representation. See [Table 1](#).

Table 1. CBRE Dual Agency Notifications

Facility	Address	Transaction	Notification Date
Westport Saugatuck Detached Box Unit	20 Saugatuck Avenue, Westport, CT	Lease of property	3/19/2012*
Santa Clarita Lyons Station	23642 Lyons Avenue, Newhall, CA	Lease of property	4/5/2012*
Oklahoma City Westside Station	5701 NW 4th Street, Oklahoma City, OK	Sale of property	6/21/2012*
Oxnard Processing and Distribution Center (P&DC)	2901 Camino Del Sol, Oxnard, CA	Sale of property	9/18/2012
Grant Street Finance Station	1001 Liberty Avenue, Pittsburgh, PA	Lease of property	10/9/2013
Alexandria Main Post Office	100 High Street, Alexandria, TN	Lease of property	10/9/2013
San Diego Scripps Carrier Annex	10060 Willow Creek, San Diego, CA	Lease of property	10/30/2013
Austin Chimney Corners Station	3575 Far West Boulevard, Austin, TX	Lease of excess property	10/31/2012
Austin Temporary Christmas Space	9401 Cargo Avenue, Austin, TX	Lease of property	11/6/2013
Van Nuys Santa Clarita P&DC	28201 Franklin Parkway, Santa Clarita, CA	Lease of property	11/29/2013

Note: *Transaction occurred before the June 28, 2012, contract modification.
Source: OIG analysis.

Real estate transactions are normally negotiated by agents who stay at arm's length from each other's interests. An arm's length transaction occurs when the buyers and sellers in the transaction act independently and have no relationship with each other. Contract terms that give too much financial control to either party and create interwoven business interests nullify the safeguards of arm's length transactions. The Postal Service continues to allow CBRE to conduct transactions despite the disclosure of non-arm's length transactions.

Appraisal Services

CBRE is responsible for the marketing, sale, leasing, and leaseback³ of Postal Service properties. Initially, CBRE also was responsible for obtaining subcontractors to perform

³ A leaseback is a financial transaction in which the Postal Service sells an asset and leases it back from the buyer for an agreed upon term.

appraisals⁴ and the required due diligence⁵ associated with these real estate transactions. To avoid conflicts of interest, the appraisal process is normally managed and performed by professionals not involved in negotiating the sales and leases or realtors marketing the properties.

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

Notification of Other Conflicts of Interest

The contract modification requires CBRE to notify the Postal Service of any actual or potential conflicts of interest—including whether CBRE or its affiliates own or have an interest in a property that may be part of a Postal Service real estate transaction. Postal Service officials stated that, to date, CBRE has not notified the Postal Service of any such conflicts of interest.

Given the multiple roles CBRE plays for the Postal Service and within the real estate industry, we are conducting a detailed audit of Postal Service real estate transactions handled by CBRE. We will examine more closely the potential for conflicts of interests; however, to immediately reduce the risk associated with the CBRE contract, we are making the following recommendation.

Recommendation

We recommend the vice president, Facilities:

1. Modify the CB Richard Ellis, Inc. (CBRE) contract to prohibit CBRE from representing the Postal Service as well as prospective buyers and lessors in Postal Service real estate transactions.

Management's Comments

Management disagreed with the findings and recommendation. Management stated that by allowing dual agency arrangements, the Postal Service can obtain wider exposure to potential offerors and, thus, ensure rigorous competition. Management also stated that dual agency arrangements are permitted under CBRE's contract with the U.S. General Services Administration (GSA) and are a common business practice in the real estate

⁴ CBRE obtained appraisals for all disposals it was responsible for and for leases valued more than \$250,000.

⁵ Due diligence is a thorough analysis of a property, which can include associated studies, market appraisals, and reviews.

marketplace. They also did not agree with our conclusion that allowing dual agency arrangements resulted in non-arm's length transactions.

Management further stated that CBRE has not reported any conflicts of interest and it does not appear that the OIG has identified any actual conflicts of interest. Therefore, management believe that the reporting and consent requirements they have instituted are sufficient to minimize any risks associated with conflicts of interest. See [Appendix A](#) for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments unresponsive to the recommendation. In regards to management's assertion that allowing CBRE to enter into dual agency arrangements is necessary to obtain wider exposure to potential offerors, we note the limited number of dual agency disclosure letters. Since the inception of the contract in June 2011, CBRE has only submitted 10 dual agency disclosure letters and reported no other conflicts of interest. Therefore, we do not believe CBRE's marketing ability would be hampered by prohibiting dual agency arrangements.

We acknowledge that a dual agency arrangement is a legal business practice and is permitted under CBRE's contract with the GSA. However, no consensus exists as to the benefits associated with it and laws vary from state to state. We do not believe allowing the arrangement is in the Postal Service's best interest. When representing the Postal Service, it is important for CBRE to be focused on maximizing revenue when negotiating sales and leases of Postal Service properties and reducing costs when negotiating leases of properties for the Postal Service to occupy. This focus is compromised when it is also representing the interests of the buyer, lessee, or lessor. We believe that dual agency arrangements give the appearance of non-arm's length transactions regardless of the controls the Postal Service has in place and the risks of allowing such transactions outweigh the benefits.

The OIG does not consider management's comments responsive to the findings and recommendation in the report but does not plan to pursue it through the formal audit resolution process. The significant recommendation will be closed with the issuance of this report. We will continue to evaluate the issue of dual agency in our current audit of Postal Service real estate transactions.

Appendix A: Management's Comments

TOM A. SAMRA
VICE PRESIDENT, FACILITIES



February 3, 2014

JUDITH LEONHARDT
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Draft Management Alert – Risks Associated with CB Richard Ellis Inc. Contract
(Report Number SM-MA-14-DRAFT)

Management appreciates the time and effort that the OIG has invested in preparing the draft Management Alert. Management, however, does not agree with the recommendation and believes that following the recommendation is not in the best interests of the Postal Service. As more fully set forth below. By allowing dual agency arrangements, the Postal Service can obtain wider exposure to potential offerors, and thus ensure rigorous competition. Moreover, management understands that dual agency arrangements have been considered and permitted under another federal government contract, and are a common business practice in the real estate marketplace. Further, it does not appear that any actual conflicts of interest have been found. Finally, management has put in place reporting and consent requirements to minimize any risks associated with conflicts of interest.

Recommendation:

Modify the CB Richard Ellis, Inc. (CBRE) contract to prohibit CBRE from representing the Postal Service as well as prospective buyers and lessors in Postal Service real estate transactions.

Management Response/Action Plan:

Management disagrees with this recommendation. By prohibiting the Postal Service's discretion to allow or deny permission to CBRE to engage in dual agency arrangements, the Postal Service could lose the opportunity to have rigorous competition for the purchase of its properties and for leasing opportunities. This could then result in a loss of valuable financial and operational alternatives. The Postal Service selected CBRE for its national scope and contacts, and it is in our best interest to have the discretion to allow CBRE to use all of its contacts to find purchasers for Postal Service's properties and landlords for leases.

In today's market concerns about dual agency have been addressed:

- (1) Governmental authorities in all 50 states who regulate real estate brokers and agents permit dual agency—most require disclosure and a few also waiver by the client. Under the CBRE agreement, the Postal Service requires both disclosure and consent;
- (2) Perceptions in government are shifting related to dual agency. State and local governments, as well as the federal government have recognized that with proper controls, dual agency does not violate ethics rules or create impermissible conflicts of interests. An example of this is the General Services Administration contract for leasing services with CBRE, which permits dual agency.

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Further, dual agency is a common and accepted practice in commercial real estate because both property owners and tenants understand that prohibiting dual agency can result in overpayments for leases, underpayments for property sales and lost opportunities to expose the needs of the seller or tenant to the broad market.

As OIG may be aware, CBRE is a \$7 billion highly regulated Fortune 500 public company. It is unlikely that the firm would risk its reputation and economic resources by violating brokerage laws. Moreover, individual brokers at CBRE have no incentive to violate brokerage laws concerning dual agency, as this could cause them to lose their livelihood because their license would be at risk. In addition, it is not true that CBRE makes any decisions with respect to property sales or leasing; rather, the Postal Service has the final say in all such matters. CBRE serves only as a conduit for information and contacts. The process for Postal Service sales and new leases of property is a public bidding process. Thus, were CBRE to attempt to provide preferential treatment for one or more bidders, the Postal Service would undoubtedly learn about this from other interested parties. Further, the warning seems to equate dual agency with a non-arm's length transaction. Management believes this is an erroneous conclusion. The buyer or landlord negotiating with the Postal Service is acting independently and typically does not have an on-going relationship with the Postal Service, with the exception of landlords with multiple Postal Service leases. The CBRE brokers involved in the transaction do not exercise, and have no authority to exercise, control over the decisions made by the Postal Service with respect to a lease or a sale. Based on the above, management does not believe dual agency is detrimental to the Postal Service real estate transactions, when properly disclosed and independently reviewed and approved or denied by the Postal Service.

Management also is concerned that the OIG has reached the following conclusion regarding dual agency in the paragraph of the section entitled "Conclusion" in the draft Management Alert:

"The contract modification also requires CBRE to notify the Postal Service of any actual potential conflicts of interest, such as owning or having interest in a property that may be part of a Postal Service real estate transaction. To date, CBRE has not notified the Postal Service of any such conflicts."

Given that the OIG recognizes that the CBRE contract requires notification of conflicts of interest, and to date no conflicts have been reported, it is unclear why the OIG would conclude, in that same paragraph that:

"Given the multiple roles CBRE plays within the real estate industry, the Postal Service should take steps to lessen the potential for CBRE to engage in transactions that create conflicts of interest."

The Management Alert also states under the heading "Notification of Other Conflicts of Interest" the following:

"Given the multiple roles CBRE plays for the Postal Service and within the real estate industry (those roles are never specifically outlined or stated in the audit), we are conducting a detailed audit of Postal Service real estate transactions handled by CBRE. We will examine more closely the potential for conflicts of interest; however, to immediately reduce the risk associated with the CBRE contract, we are making the following recommendation."

The OIG then makes the specific recommendation to modify the CBRE contract to prohibit CBRE from representing the Postal Service and prospective buyers and lessors. Management believes this recommendation is not warranted because it is not supported by any facts provided by the OIG. No conflicts of interest have been reported, nor has the OIG determined that any conflict of interest has occurred. Management understands that OIG is currently conducting an audit of real estate

transactions; however, given the facts known today, there is nothing to indicate that the risks of dual agency to which the OIG alludes have taken place.

In conclusion, management appreciates the OIG's efforts in protecting the Postal Service and looks forward to reviewing the conclusion and findings of the CBRE Real Estate Transaction Audit. Until that audit is concluded, management will continue its current practice with respect to dual agency. Specifically, management will continue to review all dual agency requests from CBRE and will continue to ensure that the execution of any future dual agency agreements is in the best interest of the Postal Service.

This report and management's response do not contain information that may be exempt from disclosure under the FOIA.



Tom A. Samra

cc: Ms. Brennan
Manager, Corporate Audit Response Management