United States General Accounting Office

GAO

Report to Congressional Committees

April 1995

OVERSEAS REAL ESTATE

Inaction on Proposals to Sell High-Value Property in Tokyo

GAO/NSIAD-95-73

GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

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April 7, 1995

The Honorable Phil Gramm
Chairman
The Honorable Ernest F. Hollings
Ranking Minority Member
Subcommittee on Commerce, Justice,
State, and Judiciary
Committee on Appropriations
United States Senate

The Honorable Harold Rogers
Chairman
The Honorable Alan B. Mollohan
Ranking Minority Member
Subcommittee on Commerce, Justice,
State, and Judiciary
Committee on Appropriations
House of Representatives

The Honorable Karen L. Thurman
Ranking Minority Member
Subcommittee on National Security, International
Affairs, and Criminal Justice
Committee on Government Reform and Oversight
House of Representatives

As part of our focus on high risk areas within the federal government, we have been reviewing the Department of State's management of government-owned real property overseas. This report contains our observations on (1) prior proposals to dispose of some U.S. properties in Tokyo, Japan, (2) the reasons the proposals were not implemented, and (3) actions that should be taken at the current time. We are providing this report because of the potential budget implications that selling, leasing, or better utilizing Tokyo properties could have. We plan to report later on State's efforts to identify real estate at other locations that does not meet U.S. government needs and to improve management of its overseas real property programs.

Background

In Tokyo, State owns residences for the Ambassador and the Deputy Chief of Mission; a 12-acre property called the Mitsui compound, which has townhouses and apartments for staff housing; and the main chancery building for most of the embassy's offices. About 3 acres of the Mitsui compound are undeveloped, except for a tennis court, playground, and a water receiving and distribution facility. Treasury owns and manages a residence, known as the Treasury House, for the financial attache (the top ranking representative from the Department of the Treasury).

Real estate values in Tokyo experienced dramatic increases during the 1980s. A State consultant reported that residential land appreciated by an average of 30.7 percent each year; the embassy's information showed a surge of 57 percent in 1987. In a March 1991 report, a contractor appraised the Mitsui compound at $3.3 billion, the Deputy Chief of Mission residence at $92 million, and the Treasury House at $15.1 million. These appraised values were based primarily on the value of the land itself.

According to embassy information, property values peaked about 1990 and have since declined. Residential land prices have declined about 30 percent since 1990, according to embassy information based on Japanese government reports. Some embassy officials surmised that the decline may be greater than that.

State's Office of Foreign Buildings Operations (FBO) is responsible for managing State's Tokyo properties as part of its worldwide management responsibilities. State owns, at more than 200 locations around the world, about 3,000 properties used for offices, housing, and other purposes, which it values at about $12 billion. FBO can sell, lease, and exchange property that is not needed for government purposes and use the proceeds for such purposes as acquiring other facilities. FBO, in conjunction with the embassies, is responsible for determining embassies' needs for facilities, comparing those needs with what is available, and obtaining or disposing of property and facilities.

Results in Brief

The U.S. government has been slow to take advantage of opportunities to sell or lease some of its high value real estate in Tokyo. Studies in 1988 and 1991 identified several options for selling or leasing some property and better using the remainder. These options included (1) selling the Treasury House; (2) selling the Deputy Chief of Mission residence and providing housing on the Mitsui compound; and (3) selling or leasing the 3-acre undeveloped portion of the Mitsui compound valued at $795 million, constructing additional housing on the remainder of the compound, which would reduce government lease costs for employees not housed on the compound, and improving other facilities.

The Treasury Department does not have explicit authority to retain proceeds from real estate sales. Thus, if Treasury sells the Treasury House, the proceeds must be returned to general receipts of the Treasury and would not be available for obligation by Treasury without new authority from the Congress. Treasury, therefore, has been negotiating to turn the property over to State, which has authority to use the proceeds from the sale of property, in return for concessions from State. However, interagency squabbles on such concessions have caused delays. In the meantime, the value of the land has decreased, and the residence has been allowed to deteriorate to the point that it cannot be occupied. As of August 1994, it was estimated that this unused property could be sold for $5 million.

Because the embassy strongly opposed the sale of the Deputy Chief of Mission residence, State rejected two FBO proposals to sell the property, even though the property is less than half an acre and was valued at about $92 million.

State has no plans to sell or lease portions of the Mitsui compound for several reasons. First, State is concerned that, despite legislation permitting it to retain the sales proceeds, it would not be allowed to retain proceeds of such a large amount—roughly twice the entire annual appropriation for overseas real property worldwide. Second, the embassy opposed the sale, and State was unwilling to proceed without embassy agreement. Third, the decline in real estate values since 1991 has decreased the potential sales proceeds.

Parochial interests governed past decisions by the embassy, State, and Treasury rather than the overall best interests of the U.S. government. Therefore, the U.S. government missed its opportunity to sell while property values were high. The value of U.S. properties is still significant, and opportunities remain for sale, lease, or consolidation of facilities on the Mitsui compound. Millions of dollars in potential sales proceeds and in lease costs hinge upon agency actions.

Although State did two major studies of real estate in Tokyo, it has not prepared a comprehensive plan for managing the Tokyo property in a cost-effective manner. The need for such a comprehensive plan is set forth in State's own policy directive and previous congressional and GAO reports.

Studies Recommended Disposal Actions

FBO contracted for two major studies of government-owned property in Tokyo to determine its highest and best use.[1] The studies completed in January 1988 and March 1991, respectively, covered the Treasury House, the Deputy Chief of Mission residence, and the Mitsui compound.[2]

- The purpose of the January 1988 study was to assess the value of, and develop an appropriate strategy for, the properties. The study considered the market value of land and replacement costs for buildings and suggested the highest and best use under different zoning or redevelopment alternatives.
- The March 1991 study was to assess the value and propose an appropriate strategy for the highest and best use of U.S. government property in Tokyo over the next 20 years, considering appraisals, market data, and applicable Japanese laws and regulations.

Both reports presented several options for meeting the Tokyo embassy's current and future needs and for generating proceeds of several hundred million dollars. In addition to selling the Treasury House, the Deputy Chief of Mission residence, and the undeveloped portion of the Mitsui compound, the studies suggested several other options.

- Sell the portion of the Mitsui compound containing 14 townhouses, Marine guard quarters, basketball court, and domestic employee quarters. A cliff or sharp break in the contour of the ground forms a natural separation of this area from the rest of the compound. (The land occupied by the Marine guard quarters, basketball court, and domestic employee quarters was valued at $145 million. It costs about $55,000 a year to maintain the domestic employee quarters.)
- Undertake a joint venture with private enterprise to develop portions of the Mitsui compound, such as the governments of Canada and Australia have done with their compounds. The Canadians retained title to their

[1]The 1991 study report defined highest and best use as that use that will, over a period of time, preserve the utility of the property and produce a net return that, when capitalized, will produce the highest value.

[2]The chancery, which State built on land leased in perpetuity, and the Ambassador residence were not included in the studies. The Ambassador residence was constructed in the 1930s and has historical significance to the United States as well as to Japan. It is located on the original site that was granted to the U.S. Legation by Japan in the late 1880s for the U.S. official mission. The residence is undergoing a major renovation, which is expected to be completed by May 1995, at a cost of about $8 million.

existing chancery site and developed it with help from a Japanese firm. In exchange for a no-income lease of surplus space on the lower floors of a new building, the Canadians received a new chancery on the upper floors, a temporary chancery, and a staff housing complex at no capital cost to the Canadian government. After 30 years, or if the developer recoups his costs before then, the surplus space reverts to the Canadians. The Australians sold a portion of the site they owned and with the proceeds built, on the remaining portion, a new chancery, a new Ambassador residence, and a staff housing complex. They also had a significant amount of proceeds left over for other purposes.

- Construct additional housing on the Mitsui compound for other agencies' employees, thereby saving the U.S. government the annual lease costs, which exceed $4 million a year. (Embassy officials oppose this option because they want to control the number of U.S. personnel in Tokyo and they believe that providing free housing on the Mitsui compound for all other agencies' employees would create incentives for agencies to increase their staff levels.)

The following sections discuss the Treasury House, the Deputy Chief of Mission residence, and the Mitsui compound.

Treasury House

State and Treasury have agreed for some time that the Treasury House should be sold. However, they have been unable to agree on how to implement the sale. Failure to expeditiously implement the sale may have cost the U.S. government as much as $18 million in lost revenue and additional appropriations.

In 1964, the Treasury Department bought the Treasury House for $150,000. It is a single family, 3-bedroom house on a one-tenth-acre lot. The house needs extensive renovation, which was estimated to cost about $150,000 in 1992, and has not been occupied since May 1994 because of its deteriorated condition. The January 1988 study valued the property at $10.3 million; the March 1991 study at $15.1 million. By August 1994, the appraised value had dropped to $5 million.

Since the 1991 Tokyo property study, State and Treasury have been considering transferring control of the property to State, which wanted to use the sales proceeds to renovate the Ambassador residence. After much back and forth between State and Treasury, the two agencies made the following formal proposals regarding the transfer of the property to State and the benefits State would provide Treasury in exchange:

- In January 1993, State proposed that Treasury transfer custody of the property to State in return for housing on the Mitsui compound for the financial attache and three staff. However, if any of the three staff could not be provided housing, Treasury would have to lease alternative housing. (Until this time, the financial attache had used the Treasury House. Other Treasury staff as well as staff from other agencies had shared available housing on the Mitsui compound after the needs of the foreign affairs agencies had been met. As of September 1994, one Treasury employee was housed on Mitsui, and two others were in leased housing, which cost about $93,000 and $84,000 annually.)
- In April 1993, Treasury made a counterproposal that would have provided a return on investment to Treasury of about $700,000 annually for 20 years, including (1) the value of housing for four employees on the Mitsui compound ($325,000); (2) the salaries and benefits of two foreign service nationals ($250,000); and foreign affairs administrative support costs ($100,000). Additionally, State would guarantee housing on Mitsui for the Treasury employees. (Housing Treasury staff on Mitsui would save Treasury money, but other agencies would have to lease more facilities off the compound.)
- In June 1993, State rejected the counterproposal and said State "cannot guarantee housing units nor will it compensate Treasury for administrative expenses and foreign service nationals' salaries since these benefits bear no relation to housing allocation."

These positions may seem to be reasonable from the perspective of the individual agencies, but they have not been in the best interests of the U.S. government and the American taxpayer. The appraised value of the property decreased by $10 million from 1991 to 1994, and FBO used about $8 million in appropriated funds in lieu of the potential sales proceeds to renovate the Ambassador residence.

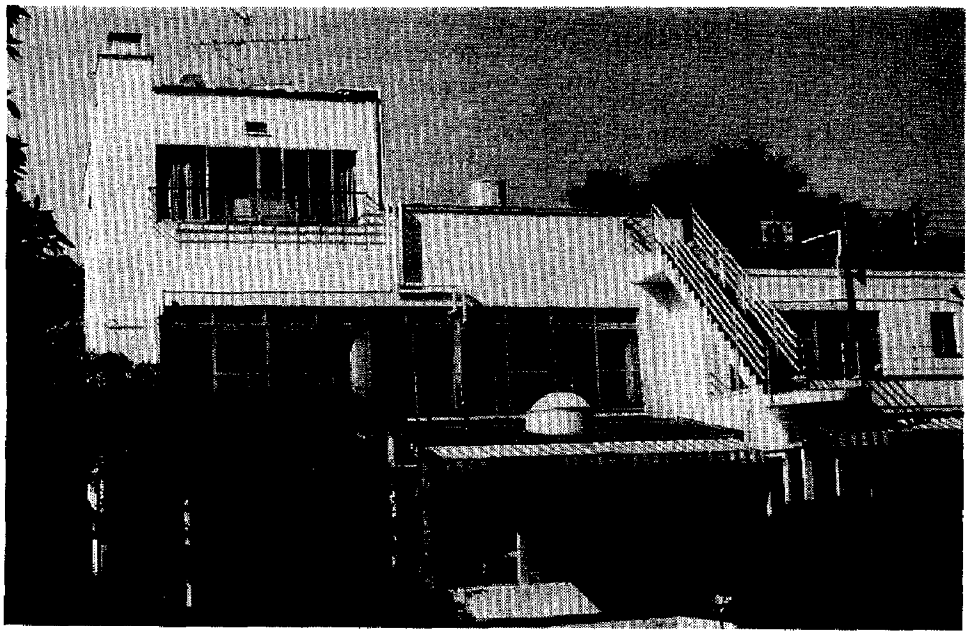
In July and August 1994, just before the results of the last appraisal were available, Treasury officials told us the property should be sold, and FBO officials told us that the sale of the residence should be imminent. However, the appraisal of $5 million in August 1994, compared with the previous appraisal of $15 million, apparently has further delayed action on the property. In October 1994, an FBO official said that FBO was pondering a further course of action. In December 1994, a Treasury official said there still was no agreement with State.

The Treasury property is not owned by State, it was not paid for with State funds, and it does not currently fall under the purview of State's legal authority to sell and use the proceeds for acquiring other facilities. Treasury, which paid for the property, no longer wants it; it is neither occupying nor maintaining the property in a usable condition; and it does not have explicit legal authority to retain the proceeds from the sale of the property. Our review indicated that the proper course of action is for Treasury to promptly dispose of the unneeded property and return the funds generated from the sale to general receipts of the U.S. treasury. Treasury could transfer control of the property to State, and State could sell it and use the proceeds, but because of the current fiscal conditions, we believe the proceeds should go to general receipts.

Deputy Chief of Mission Residence

The 1991 study appraised the property which contains the Deputy Chief of Mission residence at $92 million and estimated that it would cost $3.8 million to build a replacement residence on the Mitsui compound. State bought the residence in 1950 for $89,000. It was constructed in the 1930s and is not considered to be architecturally significant or an historic building. It contains 9,100 square feet and is on a .45-acre lot. The residence was renovated in 1990 at a cost of $1.9 million.

Figure 1: The Deputy Chief of Mission Residence



State management in Washington, D.C., rejected a proposal after the 1988 study to sell the residence because of embassy opposition. The 1988 study valued the property at about $70 million and estimated that the residence could be replaced for $2.4 million. After this study, FBO proposed selling the residence and using the proceeds for building a replacement residence, renovating the Ambassador residence, and funding critical shortages in FBO's capital construction program. State documents show that the embassy and State's East Asian and Pacific Affairs Bureau opposed the proposal because "it would degrade the representational posture of the Deputy Chief of Mission." Consequently, the Secretary of State disapproved the proposal.

Consideration of selling the residence was again dropped after the 1991 study because of embassy opposition. In a March 1991 meeting between FBO and embassy officials regarding the 1991 study options, including the Mitsui compound, the embassy maintained that the residence was too valuable an asset to embassy operations to dispose of, an acceptable alternative residence was not available, and it was needed to house the Ambassador during renovation of the Ambassador residence. (Renovation is expected to be completed by May 1995.) The embassy's objections did not address the study options to provide a residence for the Deputy Chief of Mission on the Mitsui compound and retain use of the current residence for 5 years for the Ambassador. Immediately after this meeting, FBO relented on proposals to sell the residence, but continued to push options relating to the Mitsui compound.

During our September 1994 visit to the embassy, the Ambassador and the Deputy Chief opposed selling the residence. Reasons given included its use for representational purposes and a matter of U.S. presence, image, and symbolism with the Japanese. There are currently no plans to sell the property even though the sales proceeds should be substantial and the operating costs are high. (For 1994, the estimated operating costs are over $255,000, compared with an average operating cost of $27,300 for the housing units on the Mitsui compound.) If the property were sold, representational functions could be carried out at a residence either on the Mitsui compound or elsewhere.

Mitsui Compound

The 1988 study appraised the Mitsui compound at $2.1 billion. According to the study, the compound is one of the largest and most valuable parcels of residential land in single ownership in Central Tokyo. The 1991 study appraised it at $3.3 billion. Both studies pointed out that the compound was only about 40 percent developed. Figure 2 shows the compound and surrounding area, and figure 3 identifies various features of the compound.

Figure 2: The Mitsui Compound and Surrounding Area

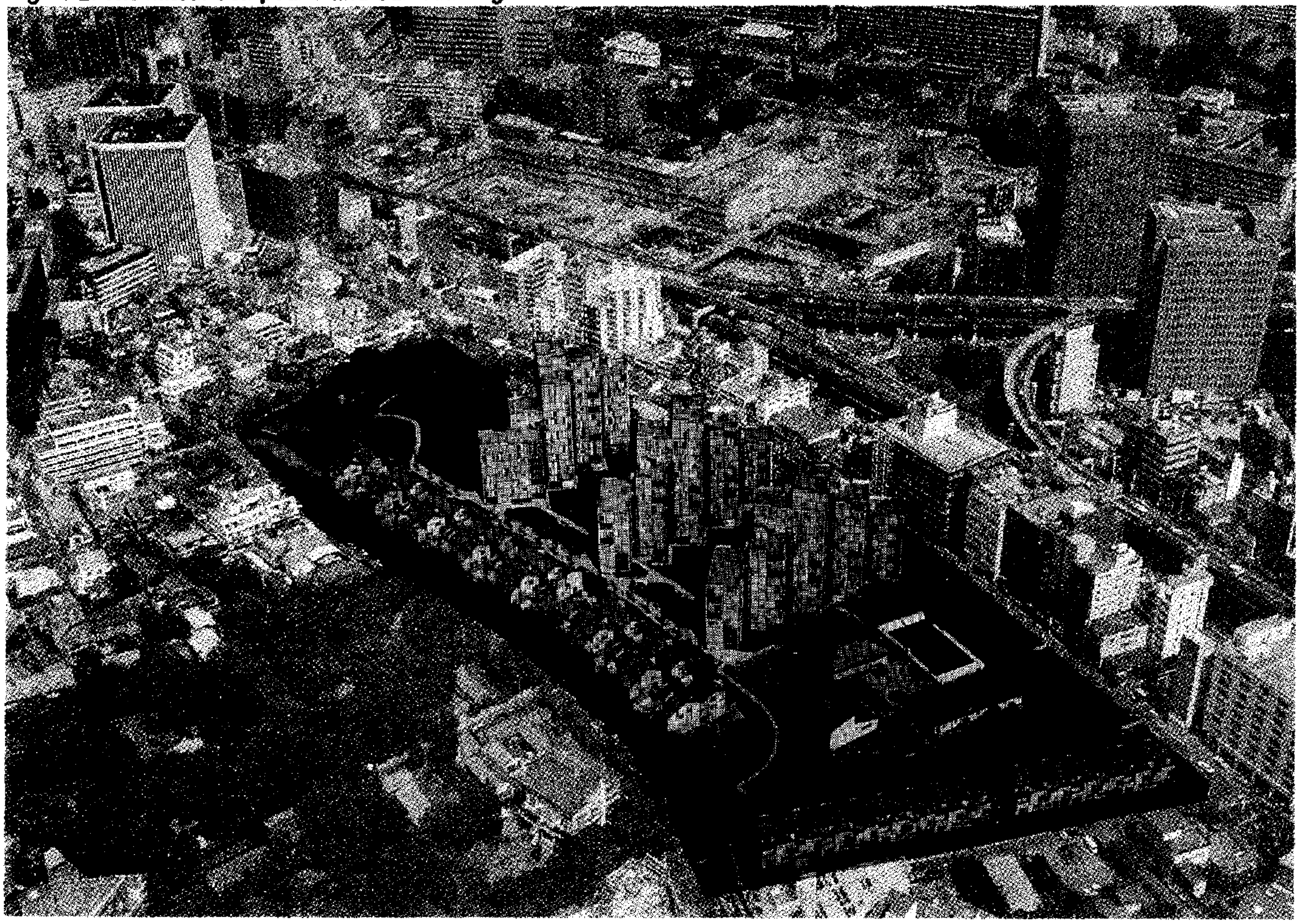
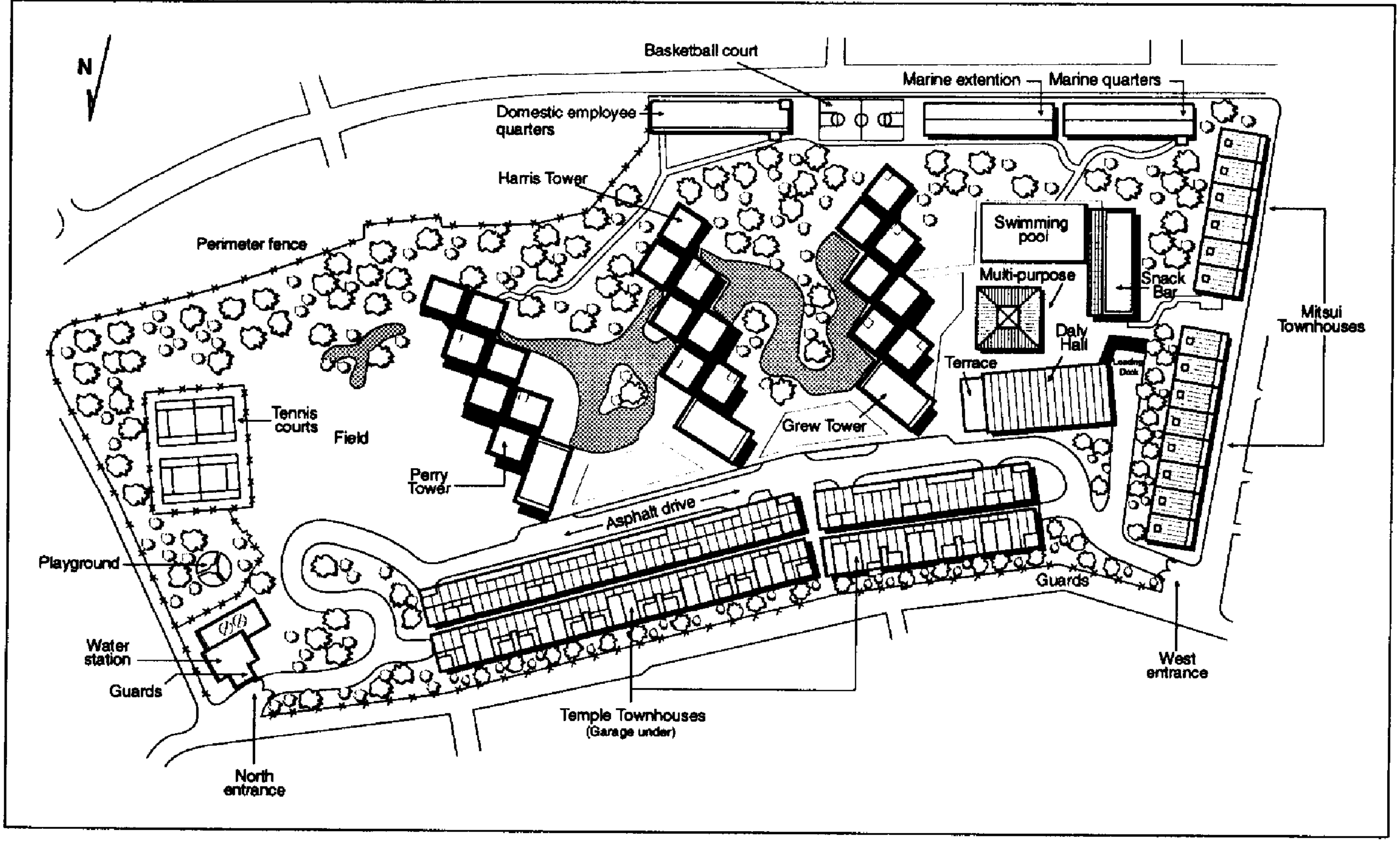


Figure 3: Features of the Mitsui Compound



State bought the 12-acre Mitsui site in 1950 for about $122,000. The property was developed in 1952; in the early 1980s, it was comprehensively redeveloped into a housing compound, as well as support and recreation facilities. Two groups of townhouses and 3 high-rise apartment buildings on the compound contain 173 housing units. Also, there are two low-rise buildings for Marine-guard housing and a similar one for domestic-employee housing on one boundary.

All State and other foreign affairs agencies' employees, except for the Ambassador and the Deputy Chief of Mission, are provided housing on the Mitsui compound, and, when available, housing is provided to employees of other agencies. As of June 1994, other agencies were spending about $4.5 million annually to lease 58 housing units off the compound. If the number of authorized personnel in Tokyo remains static, as perceived by the Deputy Chief of Mission, then the need for housing off the compound will continue.

Historically, the embassy has opposed the sale or private development of any part of the Mitsui compound because of quality-of-life concerns and a desire to retain the land for possible future use. In its February 1990 comments on the then-proposed second study, the embassy expressed concern that the concept of highest and best use would predetermine the outcome of the study in favor of economic benefits without adequately considering the reasons for being in Tokyo (i.e., to represent the United States to the government of Japan). The embassy believed it would be, in the long term, a serious mistake to sell any property currently owned in Japan. In a March 1991 meeting with FBO, the embassy remained opposed to leasing or selling any portion of the Mitsui compound in return for redevelopment on the remaining portion. In April 1991, the embassy indicated that possible future requirements include a more centrally located trade center, a new agricultural trade office, and an American center to house a portion of the U.S. Information Agency operations and perhaps other cultural establishments.[3]

In June 1991, FBO prepared a conceptual proposal to sell the undeveloped portion of the compound on an installment basis for an estimated $750 million. The proposal (1) indicated that the proceeds were to be used first to redevelop the remaining portion of the compound, such as replacing some of the existing housing units, building 60 additional units, and increasing and modernizing the recreation and support facilities for embassy employees and their families; (2) estimated that $60 million annually would be available to fund other facility requirements in the FBO's 5-year capital facility program;[4] (3) provided for possible future requirements; and (4) stated that the embassy concerns were accommodated.

Also in June 1991, the Deputy Secretary approved moving forward with planning on the proposal. However, in late October or early November 1991, State abruptly put a "hold" on disposing of a portion of Mitsui under the proposal. State officials told us that the hold was done orally. They told us that there were various reasons for the hold, such as

[3]FBO and embassy officials have also mentioned the possibility of moving the Foreign Service Institute's Japanese language training school, located in Yokohama, Japan, to the Mitsui compound since the school spends $700,000 annually in facility lease costs.

[4]Additional unfunded new office facility requirements at that time included new chanceries in Seoul, Managua, Bucharest, and Sofia and housing in China, Moscow, Eastern European posts, and elsewhere.

declining property values and other work priorities, but could provide no documentation stating the precise reasons. State's files, however, show that one reason for the hold was State's fear that it would not be allowed to retain proceeds of this magnitude, despite its authority to use such proceeds. According to FBO's Deputy Assistant Secretary, Office of Management and Budget and congressional concurrence with the proposed use of the proceeds was never sought.

Notwithstanding the hold, discussions among FBO and other State personnel of a potential sale continued into 1992. In June 1992, the Deputy Secretary and the Under Secretary for Management visited Tokyo. After this visit, the Under Secretary shifted focus from selling a portion of the compound to doing an entrepreneurial (lease/partnership) development of some of the perimeter lands. No action was ever taken. FBO personnel indicated that other work and the declining Tokyo real estate market were factors. In 1993, FBO personnel raised the issue of the Tokyo property, but dropped the issue because of the embassy's opposition and the concerns regarding use of sales proceeds.

According to State and embassy officials, there are currently no plans to develop, sell, or lease portions of the Mitsui compound.

Comprehensive Facilities Management Plan Not Prepared

In May 1991, FBO's Deputy Assistant Secretary informed us that the Tokyo studies were a key element of FBO's strategic planning process for overseas real property acquisition and disposal. However, FBO never prepared long- or short-term property management plans identifying property for disposal or acquisition, such as recommended in previous GAO and congressional reports and FBO's stated policy.

In April 1989, we recommended that the Secretary of State require the development of long- and short-term plans for systematically buying and disposing of overseas properties. Because real estate management is long term and foreign service assignments are transitory, a real estate management plan would aid in management continuity. State generally had not prepared long- and short-term country plans to determine its real estate needs and how to satisfy them. Rather, State used a technique called "rationalization," which involved selling high-dollar-value prime properties and purchasing cheaper substitute properties on an ad hoc basis.[5]

[5]State Department: Management of Overseas Real Property Needs Improvement (GAO/NSIAD-89-116, Apr. 13, 1989).

In April 1990, FBO established a policy requiring each post to have a master facilities plan that matches long- and short-term requirements with current assets to develop cost-effective alternatives for managing real estate programs. Although FBO said that the Tokyo asset studies were part of its strategic planning process, FBO did not link the studies to a complete review of post assets and a requirements analysis, as called for in its 1990 policy on master planning.[6]

In its November 1993 report, the House Committee on Government Operations also recommended that FBO establish long- and short-term plans for acquiring and disposing of government-owned property.[7] We have repeatedly reported on the overall need for such plans for a number of years, and in our view, State's management of its most valuable real estate in the world would have benefited from a plan.

Recommendations

We recommend that the Secretary of the Treasury sell the Treasury House and deposit the proceeds in the general funds of the Treasury.

We recommend that the Secretary of State sell the Deputy Chief of Mission property and provide the Deputy Chief of Mission alternative housing.

We recommend that the Secretary of State ensure that a plan is prepared and implemented for the Mitsui compound identifying Tokyo embassy's current and future facilities needs and how the compound can be used to meet those needs. The plan should consider

- providing housing for the Deputy Chief of Mission;
- providing housing for other agencies' employees, which would save the U.S. government the annual lease costs that are currently $4 million to $5 million;
- consolidating on the compound, to the extent feasible, other government facilities in Japan, such as the language training facility in Yokohama, which would result in savings to the U.S. government; and
- exploring opportunities to sell or lease portions of the compound and to use the proceeds for other needs.

[6] State Department Efforts to Improve Management of Overseas Real Property (GAO/T-NSIAD-91-40, June 20, 1991).

[7] State Department Mismanagement of Overseas Embassies: Corrective Action Long Overdue, Sixth Report by the Committee on Government Operations (H. Rept. 103-409, Nov. 22, 1993).

Agency Comments

In commenting on a draft of this report, State indicated that it felt the timing is now wrong to sell the Deputy Chief of Mission property, but the merits of such a sale should be pursued. It also indicated that it will work with the embassy to pursue a study of the embassy's long-term facility needs and how best to utilize the real property assets at the post to meet those needs. Treasury agreed that the Treasury House should be sold and indicated its intention to turn the property over to State if State will agree to provide housing for Treasury employees; otherwise, it will sell the property directly. State and Treasury's comments are included in their entirety in appendixes I and II, respectively, along with our analyses.

Scope and Methodology

We conducted our review from March 1994 to January 1995 in accordance with generally accepted government auditing standards. We interviewed personnel from the Departments of State and the Treasury and reviewed available files. We visited the government-owned facilities in Tokyo and interviewed U.S. embassy personnel. We also visited the Canadian and Australian embassies in Tokyo and discussed their management actions during the period of rising real estate values.

We are sending copies of this report to other interested congressional committees, the Secretary of State, the Secretary of the Treasury, and the Director of the Office of Management and Budget. We also will make copies available to others on request.

Please contact me on (202) 512-4128 if you or your staffs have any questions concerning this report. Major contributors to this report are John Brummet, Roy F. Hutchens, and Frederick J. Barrett.

Joseph E. Kelley

Joseph E. Kelley
Director-in-Charge
International Affairs Issues

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Abbreviations

FBO Foreign Buildings Operations

Comments From the Department of State

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of State

Chief Financial Officer

Washington, D.C. 20520–7427

FEB 8 1995

Dear Mr. Hinton:

We appreciate the opportunity to provide Department of State comments on your draft report, "OVERSEAS REAL ESTATE: Inaction on Proposals to Sell High-Value Property in Tokyo," GAO Job Code 711068.

If you have any questions concerning this response, please call Mr. Isaias Alba, A/FBO, at 875-5750.

Sincerely,

Richard L. Greene

Enclosure:
As stated.

cc:
GAO/NSIAD - Mr. Hutchens
State/A/FBO - Mr. Alba

Mr. Henry L. Hinton,Jr.
Assistant Comptroller General,
National Security and International Affairs,
U.S. General Accounting Office.

GAO's Draft Report:
"OVERSEAS REAL ESTATE: Inaction on Proposals to Sell High-Value Property in Tokyo,"
GAO/NSIAD-95-13, GAO Job Code 711068

The Office of Foreign Buildings Operations (A/FBO) offers the following comments on the above titled GAO Draft Report:

I. **SUMMARY**

See comment 1.

- The criticism of the Department regarding its failure to dispose of certain "high value" real estate in Tokyo is made in hindsight with full knowledge of the current depressed state of the Tokyo real estate market and absent recognition of the conflicting advice being offered by experts at the time. Had the Department sold the property at Mitsui before property values peaked, would GAO have criticized the Department for failing to maximize potential gain?

See comment 2.

- The characterization of the Department's role relative to Treasury House obscures the one key fact underlying this issue. Namely, the house is, and always has been, subject to the control of the Department of Treasury ("Treasury"). As such, State has no independent authority to take any action relative to this asset.

See comment 3.

- The report does not give sufficient weight to the following: (1) the significant role certain real properties play in the Department's bilateral relations with a foreign country; (2) the extent to which Post's position on the critical importance of a property must be given great weight in the Department's real property retention/disposal decision-making process; and (3) the fact that cost considerations are not the sole determinant of whether the Department sells or retains a facility meeting a validated requirement.

II. SPECIFIC COMMENTS

See comment 4.

A. Title of the Draft Report: We take issue with the title of the draft report. Use of the word "inaction" pre-judges the Department's treatment of Tokyo real estate issues and prejudices the reader before any facts are known.

See comment 2.

B. The Department's Role in Disposal of Treasury House: The draft report's tone and characterization of the Department's activities regarding Treasury House obscure the key fact underlying this issue. Namely, because the house is, and always has been, subject to the control by Treasury, the Department has no independent authority to undertake any action relative to disposition of this asset.

The Department has consistently maintained a willingness to negotiate in good faith the transfer of custody and control of Treasury House from Treasury to the Department. However, the Department has refused to forsake or compromise articulated housing policies at the expense of other government agencies simply for the sake of a deal with one agency. It troubles the Department that its refusal to concede to negotiating positions put forth by Treasury to this effect is characterized by the draft report as "inter-agency squabbling". This characterization ignores the reason underlying the Department's rejection of Treasury's proposals as well as the Congressional mandate for, and the Department's considerable efforts concerning, creation and implementation of fair, even-handed, housing policies worldwide.

The Department remains willing to proceed with disposal of Treasury House pending transfer of custody and control from Treasury to State and the existence of market conditions conducive to sale. Should Treasury decide to proceed in this regard, one unit will be made available at Mitsui Compound for the Financial Attache.

See comment 5.

Embassy Tokyo observed that the draft report states that providing housing for other agency employees (Treasury) would save lease costs. The post believes that offering free housing would encourage other agencies to increase their staff at post, because they would be able to use their base funds for additional personnel in lieu of the lease costs. The post does not believe any savings would result.

See comment 6.

C. The Department's Actions Regarding the Deputy Chief of Mission's Residence (DCR): The characterization of the Department's actions regarding the DCR ignores the following: (1) the significant role the DCR plays in the Department's bilateral relations with Japan; (2) the extent to which Post's position on the critical importance of the DCR must be given significant weight in the Department's retention/disposal decision-making process; and (3) the fact that cost considerations are not the sole determinant of whether the Department sells or retains the DCR given that it meets a validated requirement.

The draft report highlights the role Post and the Bureau of East Asian and Pacific Affairs played in the Department's decision not to sell the DCR. However, the specific nature of their position is glossed over. Specifically, as set forth in 88 Tokyo 18191, a cable addressed to the Secretary of State from then Ambassador Mansfield stated:

> The importance of Japan as a political and security ally, a global economic and financial powerhouse of the twenty-first century, dictate that we not denigrate our capability of managing relations with Japan. Representation and prestige are important in Japan, and the DCM, no less than the Ambassador, must be in a position to entertain Japanese cabinet level officials, prime ministerial candidates, and other top political and economic leaders to maintain close contact and influence and for prestigious visitors from the United States. For the United States to join second and third world countries in selling their property in Tokyo because of budget stringencies is not the signal we should send to Japan.

Coming from the highest levels of the Mission, the Department appropriately gave great weight to this firm position. To have done otherwise would have allowed real property values to dictate the Department's course of action regardless of the impact on our bilateral relations with the host government.

However, the draft GAO report suggests just the opposite and expresses a narrow view with its continued emphasis on the high value of the DCR, its cursory acknowledgement of the reasons for Post's opposition to the disposition, and the current recommendation that A/FBO sell the DCR because of its significant value. What the report fails to recognize is the appropriate level of discussions and consultations that existed between Post, the Bureau, and A/FBO in determining the course of action to follow. From this deliberative process emerged a decision not to sell the DCR because of the negative impact disposal would have on bilateral relations. GAO may not prefer the decision the Department made, but it should not fault the ordering of priorities.

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See comment 7.

The Department also believes the recommendation to pursue sale of the DCR at this time is wrong. By its own admission, the GAO draft report acknowledges that the Tokyo real estate market is currently at the bottom of a boom/bust cycle. In light of this fact, the better recommendation would be continued retention of the DCR, further consideration of the merits of disposal by the Department, and assuming a strong justification for disposal emerges from the study, sale of the asset at a later date when better market conditions prevail.

See comment 8.

Embassy Tokyo observed that page 11 of the draft report asserts that the operating costs of the DCM residence are high. The post did not know where the audit team obtained reported costs but was concerned that the report was mixing "apples and oranges." The DCR is 9000 square feet in size while the average Mitsui Compound unit is about 1200 square feet. Also the post was unclear whether official representational expenses were incorporated into these costs as they would be incurred wherever the DCM lived.

See comment 9.

D. <u>The Department's Actions Regarding Redevelopment of a Portion of Mitsui Compound:</u> In discussing the Department's actions regarding redevelopment of Mitsui Compound, the draft report suffers from many of the same defects highlighted under the DCR discussion above. Namely, the emphasis is on the dollar value of the property with little regard for Post's articulated foreign policy and, in this instance, quality of life concerns. Moreover, the report makes light of the extensive work undertaken by the Department in pursuing this complex asset management initiative.

The Department will work with Post to pursue a study of Post's long term facility needs and how best to utilize real property assets at Post to meet these needs. However, we fear that the underlying tone of the draft report is one whereby the only acceptable outcome of such a study is a recommendation to redevelop a portion of the Compound consistent with the report's enumerated study guidelines. This would appear to preclude an objective study and render the Department susceptible to future criticism if the study's findings lead the Department to decide to the contrary.

See comment 10.

Embassy Tokyo stated that page 15 of the draft report erroneously states that the Department bought the Mitsui Compound in 1950 and developed it in the early 1980's. The property was developed in 1952 and comprehensively redeveloped in 1980-1982. Also the post pointed out that on page 15 the draft report states that "All state employees...are provided housing on Mitsui Compound and, when available, housing is provided to employees of other agencies." In fact, the employees of all foreign affairs agencies, (i.e., State, USIA, FCS, FAS, and DIA), are provided housing. Other agencies are provided housing on a space-available basis under a formula determined by the Inter-Agency Housing Board.

- 5-

See comment 11.

Embassy Tokyo observed that page 4 of the draft report states hindsight is used to reach the judgment that the Department should have sold the properties in question in 1991. The post recalls that the most knowledgeable observers at the time opined that A/FBO would be crazy to sell real estate in Tokyo. The post also pointed out that the 30 percent decline in the value of the dollar against the yen has provided a substantial hedge against the decline in the yen value of local real estate.

See comment 12.

E. Embassy Comments on Draft Report: Embassy Tokyo is willing to participate in a study to examine the alternative uses of Department-owned properties in Japan. The post cautions that there may be considerably less developable space on the Mitsui Compound than GAO believes there is. For example, extensive geotechnical studies are necessary before construction could be carried out in the undeveloped sections of the Compound. The post identified the west end of the Compound as a potential site for high-rise construction. The Marine House, basketball court, and domestic employee quarters could be sold, but the new tower would have to provide for a DCR, 18 apartments for Marines, as well as recreational facilities (pool, gym, and community center.) This would severely limit the number of residential apartment units available to others. The post also pointed out that relocation of the Foreign Service Institute field school to the Mitsui Compound would have the double benefit of saving lease costs and providing additional property in Yokohama for sale.

The following are GAO's comments on the Department of State's letter dated February 8, 1995.

GAO Comment

1. State-funded studies recommended several viable options to capitalize on the properties increased value, but State chose to ignore the advice of the experts it hired. This has cost the taxpayers a great deal of money—enough to cover about the Foreign Buildings Operations' (FBO) entire budget request for the next 2 years.

2. The report recognizes Treasury's control of the Treasury House and recommends that Treasury sell the property and return the proceeds to general receipts. The report lays out State's and Treasury's inability to agree on disposal of the property. Both State and Treasury may feel that their independent positions were reasonable, but the failure to reconcile these positions led to a result that was not in the best interest of the U.S. government, and it may have cost the government and the taxpayer as much as $18 million.

State indicates that it has no authority to take independent action regarding the Treasury House, but it is willing to take control of the property, and depending on market conditions, sell it. Under this procedure, the proceeds would be available to State for its use. Because of fiscal constraints, our position is that Treasury should sell the property and return the proceeds to general receipts. Also, we question State's ability to predict future market conditions. The U.S. government should not continue to hold properties that are unneeded.

3. The report pieces together the available information from State's files and shows the decisions made and the basis provided for those decisions. To the extent that factors were cited as a consideration in the decision-making process, they are included in the report. The report presents the overwhelming weight given to the embassy position in the decision-making process over the results of the State-funded studies. State's files show that one reason for not developing the Mitsui compound was its concern that it would lose the use of the proceeds.

We have previously recommended that State develop property management plans, and State issued a policy directive with this requirement. However, State never developed such a plan for Tokyo, its most valuable property. If it had developed such a plan, then relevant factors and the weight assigned to them regarding the property would be a matter of record.

4. The report title reflects the report's message. We made no changes.

5. Personnel authorizations at the embassy are approved through an interagency process based on need. If additional personnel are assigned to the Tokyo embassy, then costs likely would increase. Lease costs of $4 million to $5 million are being incurred because housing is not available on the Mitsui compound. Treasury's comments on a draft of this report (see app. II) show that it is incurring over $1 million annually for lease costs for employees of the Office of International Affairs, Customs Service, and the Internal Revenue Service.

5. State's comment that budget constraints are not a reason to sell the Deputy Chief of Mission residence is troubling when the entire government is looking for ways to cut costs and find revenues. State's view that the residence plays a significant role in bilateral relations with Japan raises further questions as to why State incurred significant costs in 1988 and again in 1991 to study, among other things, the sale or retention of this property. One option of the 1991 study was to provide the Deputy Chief of Mission a house costing about $4 million on other State-owned property and to sell the property containing the Deputy Chief of Mission residence, which was then valued at $92 million. As pointed out in the report, the embassy opposed the sale because it believed the representational posture of the Deputy Chief of Mission would be degraded. The report further stated that, if the property were sold, representational functions could be carried out at a residence on the Mitsui compound or elsewhere. The present Deputy Chief of Mission confirmed this during our visit. State said it gave great weight to the embassy's firm position to not sell the residence. Our report acknowledges this, but questions whether the embassy's position represents the best interests for the U.S. government.

7. State has no way of knowing whether Tokyo real estate is currently at the bottom of a "boom/bust cycle" or if the value of real estate will go up. The State proposal basically is to sell the Deputy Chief of Mission residence if prices go up. Again, we question State's ability to assess future real estate market conditions.

8. Embassy personnel provided information showing an estimated 1994 operating cost of $255,000 for this 9,000-square-foot residence, whereas

operating costs for Mitsui residences were $27,300. Representational expenses of the Deputy Chief of Mission and other embassy personnel are paid separately and not included in the above amounts.

9. The report cites what happened as shown by State's files. The Deputy Secretary approved plans to proceed with developing the Mitsui compound. According to State Department documents, one reason for State's "hold" on development efforts was its concern that it would lose the multi-million dollar proceeds involved.

It is not our intent to bias future studies of the use of the Mitsui compound, but our recommendations should be considered in such a study. In today's environment, we believe the dollar values of the properties should play a significant role in the outcome of such study.

10. We have modified the report to reflect this comment.

11. The embassy's comment reinforces our concern for State's basis for determining future real estate market conditions. Embassy officials told us that, in 1991, the prevailing view was that real estate values could only continue to go up, but time has shown that view was wrong. As the report points out and State's comments indicate, property values have declined; however, they are still significant.

Regarding the embassy's recollection that knowledgeable observers believed that FBO would be "crazy" to sell real estate in Tokyo, FBO did two studies that showed the economic feasibility of doing so, and the Deputy Secretary approved of preparing plans for such a sale.

12. These comments suggest that the embassy concurs with our third recommendation.

Comments From the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 7, 1995

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Hinton:

We have reviewed your draft report on the Department of State's management of government-owned real estate overseas in Tokyo, Japan (GAO code 711068). Our comments follow.

Treasury House

On March 24, 1964, the United States Government acquired, on behalf of the Department of the Treasury, a single family, three-bedroom house on a one-tenth acre lot to serve as the residence of the Treasury financial attache assigned to the U.S. Embassy. The house (originally constructed in 1961) and land was purchased at a cost of $150,000 and was deeded to the United States Government. The title and registration were signed by John K. Emmerson, the Charge d' Affaires ad interim (i.e. Deputy Chief of Mission) of the United States Embassy. The property is located at 1-38, Mita 2-chome, Minato-Ku, Tokyo, Japan.

For thirty years, the house has served as residence for various Treasury financial attaches and their families. Maintenance costs have averaged $15,000 annually. The combined average annual expense of $20,000 (maintenance plus purchase cost divided by 30 years) is well below the cost of leasing a residence in the marketplace (average annual cost for 58 housing units leased by the U.S. Embassy was almost $78,000 at the end of June 1994).

Over the last few years, the condition of the house has deteriorated -- a normal situation for a thirty year old wooden structure. In May 1992, a private Japanese firm (Taihei Kensetsu Company, Limited) performed a detailed inspection of the house and submitted cost estimates of 20 million to 43 million yen ($200,000 to $430,000 at today's exchange rate of 100 yen to the dollar) to completely renovate the Treasury house, including air-conditioning, heating, sanitation, electrical wiring, roofing, replacement of rotting wood, and installation of fire-resistant boards. Since the house itself was only appraised at a value of 4.34 million yen in 1990 ($43,400 at current exchange rates), we recognized that it would be unwise to spend large sums (five to ten times the house's value) to renovate it.

See comment 1.

2

In May 1994, the Treasury financial attache departed Tokyo for reassignment in Washington, D.C. As a result, we decided to; (1) house the new Treasury financial attache elsewhere (employee is now housed in leased residential space); (2) forego any renovation and most maintenance expenses (except to physically secure the structure); and (3) consider declaring the residence (structure and land) as property excess to the needs of the Department of the Treasury. Our decision to declare the Tokyo residence as excess property reflects primarily the fact that the house itself (structure) has come to the end of its usable life and secondarily that the current fair market value of the land upon which the structure sits will return, upon its sale, a significant capital gain for the United States Government.

We agree with your recommendation that the attache residence in Tokyo, Japan be sold. We intend to transfer the real property to the Department of State in exchange for some "credit" (e.g. housing on Mitsui compound rent free) from the sale proceeds to offset increased housing costs and to help achieve budgetary reductions in administrative expenses against our annual operating appropriations. If agreement is not reached with the Department of State within a reasonable period of time, we will then take appropriate actions at additional expense (e.g. engage services of commercial broker etc.) to dispose of the house.

It is our understanding that the Department of State intends to sell this property when it has been declared excess and has been transferred to the Department of State.* A fairly recent appraisal (August 1994) prepared by a certified Japanese real estate appraiser (Hiroyuki Isobe) and submitted to the United States Embassy in Tokyo estimates that the fair market value of the property is 500 million yen ($5 million). Thus, the eventual sale of the Treasury house (structure and land) should result in a significant return on initial investment (over twelve percent annually). It should be noted, however, that this property was acquired not for investment purposes but for the residential housing needs of the financial attache. When the house was purchased in 1964, the Treasury financial attache, his wife and three small children were living in unsatisfactory and expensive rental units and had been forced to move a number of times in the preceding twelve months since their arrival in Tokyo in early 1963.

* Under 40 U.S.C. sections 511 to 514, an executive agency (e.g. the Department of the Treasury) can dispose of foreign excess property so long as such disposition conforms to the foreign policy of the United States.

3

Mitsui Compound

The Department of the Treasury has consistently supported and requested that its employees, stationed permanently overseas, be housed in government-owned quarters. This approach is the most economical and beneficial for employee productivity.

There are four employees of Treasury's Office of International Affairs currently assigned to U.S. Mission in Tokyo. They work in the core building of the Embassy. Only one, a GS-8 secretary, is housed in the Embassy's Mitsui compound. The remaining three employees are housed off-site in leased residential units at an annual cost of almost $375,000 (average lease cost of $125,000). At the same time, all employees of the Department of State (except the Ambassador and the Deputy Chief of Mission which are housed in separate government-owned facilities) are housed in the Mitsui compound at an average annual cost of $27,300.

The Department of the Treasury supports your recommendation that a "plan is prepared and implemented for the Mitsui compound .... providing housing for other agencies' employees which would save the U.S. government the annual lease costs that are currently $4 million to $5 million annually." The Department of the Treasury itself is spending over $1 million to house ten employees in leased residential space. * We would expect that the Department of State would provide housing on the Mitsui compound for employees of the financial attache's office in recognition of our plan to declare the Treasury house as excess property and its subsequent sale by the Department of State.

Application of Sale Proceeds (Treasury House)

See comment 1.

The General Accounting Office in the draft report proposes that "the Secretary of the Treasury sell the Treasury House and deposit the proceeds in the general funds of the Treasury." We plan to excess the Treasury House and transfer it to the Department of State for disposal.

* In addition to the Office of International Affairs (3 employees with annual lease cost of $375,000), the Customs Service spends $415,000 to house 4 employees and the Internal Revenue Service spends $298,000 to house 3 employees in leased space. Only 1 employee (as noted in text) is housed on the Mitsui compound.

4

We understand that the Department of State has authority, 22 U.S.C.300 (a) and (b), to retain proceeds from sale of real property overseas for deposit into its Foreign Service Buildings Fund. Such proceeds could be used to acquire and/or upgrade facilities at United States missions throughout the world. The Department of the Treasury must refer any recommendation on specific application of sale proceeds to the Department of State. We are requesting that housing on the Mitsui compound be made available for employees of Treasury's Office of International Affairs.

We appreciate this opportunity to provide you with our comments and observations. Please contact me on 202 622-1209 for additional information.

Sincerely,

Daniel A. O'Brien

Daniel A. O'Brien
Acting Director
Office of Program Services
(International Affairs)

cc: Jeffrey Shafer, Assistant Secretary (International Affairs)
Department of the Treasury

George Muñoz, Assistant Secretary (Management)
Chief Financial Officer, Department of the Treasury

Patrick F. Kennedy, Assistant Secretary (Administration)
Department of State

Jerome Tolson, Deputy Assistant Secretary
for Foreign Buildings Operations,
Department of State

Timothy Geithner, Deputy Assistant Secretary
International Monetary and Financial Policy
Department of the Treasury

The following is GAO's comment on the Department of Treasury's letter dated February 7, 1995.

GAO Comment

1. As indicated in the report, we believe that Treasury should sell the Treasury House and deposit the proceeds into general receipts. If necessary, it should use the embassy's administrative capacity to do this.

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