United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
2:00 p.m.
Wednesday
November 13, 1991

Proposed Sale of Federal Land to the Columbia Hospital for Women

Statement of
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General Government Division

Before the
Subcommittee on Public Buildings and Grounds
Committee on Public Works and Transportation
House of Representatives

GAO/T-GGD-92-7

PROPOSED SALE OF FEDERAL LAND
TO THE COLUMBIA HOSPITAL FOR WOMEN

SUMMARY STATEMENT OF
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H.R. 2570 would authorize the sale of government-owned land located at 2400 M Street NW in the District of Columbia to the Columbia Hospital for Women for $12 million. The Subcommittee on Public Buildings and Grounds of the House Committee on Public Works asked GAO to summarize its work on the value of this land and to assess the financial condition of the Hospital.

Since 1988 there have been several appraisals of this land. An appraisal prepared for GAO determined the fair market value of the land was $20 million in October 1988. In February, 1989, Columbia Hospital obtained an appraisal which estimated the value at $9 million--less than half of GAO's appraisal estimate. The principal difference in these appraisals is that the one prepared for GAO followed federal appraisal standards, while the other did not. The Hospital had another appraisal done in April 1991 that estimated the value of the land, with a $3 million deduction for zoning related costs, was $13 million. Also, in October 1991, GSA obtained an appraisal that estimated the land's value was $18 million. Any difference between the sale price and the fair market value of the land constitutes, in effect, a subsidy for promotion of health care. H.R. 2570 recognizes this by requiring the Hospital to provide services to high need areas in the city.

To assess the Columbia Hospital's ability to pay for and develop the property, GAO analyzed the Hospital's consolidated financial statement for the years ending June 30, 1989 and 1990. While the Hospital was generally in comparable or better financial condition than the industry as a whole, its financial condition deteriorated somewhat in 1990. GAO was not able to completely assess how the proposed health resource center will affect the financial viability of the Hospital because Hospital officials did not provide all the needed information. GAO did review the revenue and expense forecast for the center and found estimates of three major areas that were inconsistent with industry standards or the Hospital's past performance, and the available supporting data did not explain these differences. Because the costs for the proposed center represent a significant financial undertaking for the Hospital, GAO supports the concept of providing for the land's reversion if the Hospital is unable to build the center.

Mr. Chairman and Members of the Subcommittee:

We welcome the opportunity to appear before you today to assist the Subcommittee in its consideration of H.R. 2570, including the Subcommittee's draft amendment in the nature of a substitute dated October 30, 1991. This bill would authorize the sale of government-owned land, located at 2400 M Street NW in the District of Columbia, to the Columbia Hospital for Women. You asked that we discuss work we have done regarding the fair market value of this land and the financial condition of Columbia Hospital.

Value of the Land and the Sale Price

Since 1988, there have been several appraisals of this government-owned parcel of land. We had an independent appraisal done and the Columbia Hospital for Women has obtained two appraisals. Also, GSA had an appraisal done in October 1991. In March 1989, we issued a report that discussed the results of the independent appraisal we obtained on the value of this land[1]. Our appraisal estimated the land's fair market value on October 31, 1988 was $20 million. The Columbia Hospital for Women's first appraisal estimated the land's market value in February,

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[1]Federal Real Property: Appraisal of Land to Be Sold to Columbia Hospital for Women, (GAO/GGD-89-46, Mar. 10, 1989.)

1989 was $9 million--less than half of the estimate made in our appraisal. We issued a follow up report in December 1989, contrasting the differences between this appraisal and ours. We reported that the principal difference between our appraisal and the Hospital's appraisal is that ours followed federal appraisal standards and the Hospital's did not.[2] Consistent with federal policy, our appraisal based the fair market value on the highest and best use of the land. Columbia Hospital's appraisal based the property's market value on the limited development the Hospital proposed at that time and did not consider recent sales of land in the area.

In April 1991, the Columbia Hospital for Women's second appraisal was done. Like our appraisal, this appraisal followed federal appraisal standards; it applied the highest and best use standard, used confirmed sales of comparable or nearly comparable land, and did not diminish the value of the land based on the Hospital's intended use. This appraisal estimated the total value of the land at about $13 million, but this estimate included a $3 million discount from the value of the land for time and costs associated with zoning approval. If, however, the appraiser had decided not to discount the value, based on the appraiser's estimates of the value per square foot, the value of the land could be about $16 million: $300 per square foot times

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[2] Federal Real Property: Conflicting Appraisals of Land Near Columbia Hospital for Women, (GAO/GGD-90-15, Dec. 11, 1989.)

the lot size of 53,437 square feet is $16,031,000. Zoning discounts account for costs the purchaser may incur, such as taxes, interest or public interest concessions, while bargaining for zoning approval. These costs can be offset by rising land values over time or by a zoning decision more favorable than anticipated. Thus, whether or not the appraiser discounts the value of a property and how much that discount should be is a decision made by each appraiser, on each case. For example, the GSA obtained appraisal estimated the total value of the land, as of October 1991, was about $18 million. This appraiser estimated that zoning related factors could either increase the land's value to about $19 million or decrease it to about $16 million.

Under the proposed amendment to H.R. 2570, the land would be sold for $12 million, with $5 million paid at the time of conveyance and $7 million to be paid over a 9-year period beginning in the end of the third year after conveyance. Because GSA is to charge a market based interest rate on the outstanding balance of the purchase price beginning on the date of conveyance, the present value of the purchase price is also $12 million. Payments would be paid into the Federal Buildings Fund, which will help finance operating and capital costs associated with providing and maintaining federal facilities.

It is important to recognize that the sale of this land at any price lower than the highest and best use value of the land would be the same as providing a subsidy for the use proposed by the purchaser. For example, if the highest and best use value of the property is between $16 and $20 million, and if the government sells the property for $12 million, the purchaser implicitly receives a $4-$8 million government subsidy. Under H. R. 2570, as amended, the Hospital will, in effect, be required to reimburse the public for this subsidy by providing services and benefits. Specifically, the Hospital is obligated to establish, maintain and operate at least three satellite centers, within four years after the date of conveyance, that will be located in areas with the highest rates of infant death and births by teenagers.

There are some ambiguities in the language of the proposed amendment to H. R. 2570, and we would be glad to work with the Subcommittee to make the language--such as on repayment terms--more specific.

Hospital's Financial Condition

In addition, because of your concern about Columbia Hospital's financial ability to both pay for the land and construct a new center, we did an analysis of the Hospital's financial condition for the years ending June 30, 1990 and 1989. Our analysis showed that although Columbia Hospital was generally in comparable or better financial condition than the industry as a whole, the financial position of the Hospital deteriorated somewhat from 1989 to 1990. To assess the Hospital's financial condition, we used the 6 building blocks of financial analysis--short term liquidity, cash flow, capital structure/long-term solvency, return-on-investment, operating performance, and asset utilization. This analysis showed that:

-- Columbia's ratio of total liabilities to total equity was better than the industry average with its debt ratio at about the industry average. As of June 30, 1990 and 1989 Columbia Hospital's ratios of liabilities for every $1.00 of equity were about 1.4 in 1990 and about 1.7 in 1989; better than the 2.5 industry average. Columbia Hospital's debt ratio was .58 in 1990 and .62 in 1989, comparable to the industry average of .62.

-- Columbia earned above hospital industry averages on its return on total assets and total equity. For 1990 and 1989 Columbia Hospital earned 3.8 and 4.2 percent, respectively, on its total assets while the 1989 industry average was 3.9 percent. Additionally, Columbia Hospital earned 9.1 percent in 1990 and 11.1 percent in 1989 on its total equity, which was better than the 1989 hospital industry average of 7.8 percent.

-- Columbia Hospital's operating performance, based on the gross revenue writeoffs and the operating margin, was comparable to industry averages. For 1990 and 1989 Columbia Hospital wrote-off 27.1 and 25.6 percent respectively of its gross revenues which was comparable to the 1989 hospital industry average of 27.3 percent. Its operating margin, the ability to generate income to sustain operations, of 2.1 percent in 1990 and 3.1 percent in 1989 was comparable to the hospital industry average of 2.2 percent.

Columbia Hospital's cash flow as identified from operating, investing or financing activities decreased by $7.4 million in 1990 after a 1989 increase of $8.6 million. Cash from operations decreased to $2 million in 1990 from $6 million in 1989 primarily as a result of decreases in net income and depreciation/amortization. Cash from investment activities decreased $3.3 million in 1990 and $27.7 million in 1989 primarily due to purchases of fixed assets and contributions to the self-insurance trust fund. Cash flows from financing activities decreased in 1990 by $6.1 million primarily due to an equity payment to a healthcare group. Furthermore, in 1990 Columbia Hospital began a major facility renovation project. The $25 million committed to this renovation significantly increased the Hospital's debt load.

We have not been able to completely assess how the construction and operation of the health resources center will affect the financial viability of the Hospital because the Columbia Hospital officials chose not to provide us all the needed information. In order to make a complete assessment on the impact of this center, we would need to review a forecasted balance sheet and a cash flow statement. A review of the balance sheet would enable us to assess various ratios and a cash-flow statement would enable us to estimate whether the center will be able to generate sufficient receipts to pay its obligations. We have not been able to obtain either of these documents.

However, we were able to obtain publicly available information from the District of Columbia Health and Planning Agency on the Hospital's revenue and expense forecast for the Center and several documents with data supporting the forecast. Usually, for projects of this magnitude, lenders require a 5-year forecast but the Columbia Hospital for Women prepared a 3-year forecast. This forecast, prepared in October 1989, does not estimate the costs for the three satellite centers, now required in H. R. 2570.

Several line items on the forecast are inconsistent with industry standards or the Hospital's past performance and the accompanying supporting data does not explain these differences. Specifically, we have concerns about three major areas.

First, the deductions from revenue may be too low. The deductions from revenue include expenses incurred for free care, bad debts and contractual allowances, which are expenses not covered or for which reimbursement is limited by Medicare and insurance firms. The forecast estimated these deductions would be about 13% in the first year and 11% in the second and third years. These estimates are half of the 1989 industry average of about 27% as well as the Hospital's own revenue deductions of about 25% in 1989. If the Hospital had estimated the deductions at its 1989 rate of 25%, than the net revenue estimates would have been reduced by 12%--from $4.3 million to $3.7 million.

Second, the Hospital estimated a significant 44 percent increase in net revenues in the second year and 13 percent in the third year. These increases enable the forecast to show a 4 percent profit after the second year of operation. However, if the Hospital had used the industry average of a 20 percent annual net revenue increase in its forecast, then a profit would not be realized until the fifth year.

Finally, the estimated costs for physician contracts, other direct expenses, and indirect expenses may be understated. In 1989, these costs were 40 percent of the Hospital's total operating revenue. The forecast estimated lower costs for the first three years at 32 percent, 26 percent and 25 percent respectively. If the Hospital had estimated these expenses at its 1989 rate of 40 percent, then the operating expenses would increase from $5.1 million to $5.4 in the first year.

Without more specific information we cannot explain the inconsistencies or differences between the forecast estimates and the industry averages or the Hospital's performance measures.

Also, it is important to note that the estimated cost of the health resource center, plus the as yet undetermined costs for the satellite centers, will represent more than 38% of the Hospital's assets. While the Hospital estimates $10 million of the cost will be obtained from a capital campaign, this may be difficult to accomplish in the current economic environment. Furthermore, while the Hospital had secured a letter of credit to borrow $20 million from a bank, this commitment expired on August 1, 1990 and as of October 22, 1991, had not been renewed.

The Hospital's undertaking is significant and ambitious. The Hospital could obtain the land and be unable to construct the center as planned for several years, or in the worst case, not at all. There also is the possibility that, even if constructed, the center may not achieve financial viability.

Therefore, we support the concept embodied in the proposed amendment to the H.R. 2570 conveyance terms that provides for the land's reversion back to the United States under certain stipulated situations. Without this provision, if the Hospital cannot both pay for the land and construct the center, the result could be that everyone loses. That is, the D.C. community would not have a health resource center, and the federal government would not have either the land or the opportunity to use it for an office building. Furthermore, Columbia Hospital may well have to incur additional debt in its efforts to get the center built and operating.

We recognize, however, that there are public policy choices associated with selling or keeping this land that are not fully encompassed by considering only the appraisals or the financial health of the Hospital. If enacted, H.R. 2570 could contribute to the promotion of health care. As envisioned, the proposed women's resource center is intended to provide programs, services, and activities that will help address several of the problems associated with health care in the nation.

But there is also an opportunity cost associated with the proposed transaction. If H.R. 2570 is not enacted, GSA would then be able to keep the land for its proposed use--the construction of a federal office building that would help reduce the government's dependence on costly leased office space in the

Washington, DC area. We have issued a series of reports and testimonies documenting that this need is real[3].

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This concludes my prepared statement and I would be pleased to respond to any questions.

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[3]Public Buildings Service: GSA's Projection of Lease Costs in the 1990s, (GAO/GGD-89-55, Apr. 19, 1989.)

Public Buildings: Own or Lease? (GAO/T-GGD-89-42, Sept. 26, 1989.)

Federal Office Space: Increased Ownership Would Result in Significant Savings, (GAO/GGD-90-11, Dec. 22, 1989.)

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