



Testimony
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Subcommittee, Committee on Oversight
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Representatives

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VA REAL PROPERTY

Actions Underway to Improve the Leasing of Outpatient Clinics

Statement of David Wise, Director
Physical Infrastructure Team

Accessible Version

GAO Highlights

Highlights of [GAO-15-723T](#), a testimony before the National Security Subcommittee, Committee on Oversight and Government Reform, House of Representatives.

Why GAO Did This Study

VA operates one of the nation's largest health-care delivery systems. To help meet the changing medical needs of the veteran population, VA has increasingly leased medical facilities to provide health care to veterans. In April 2014, GAO reported that VHA's leasing program had long-term liability of \$5.5 billion and was growing.

This statement discusses VA outpatient clinic lease issues, specifically, (1) the extent to which schedule and costs changed for selected VA outpatient clinics' leased projects since they were first submitted to Congress and factors contributing to the changes and (2) actions VA has taken to improve its leasing practices for outpatient clinics and any opportunities for VA to improve its project management. It is based on GAO's April 2014 report (GAO-14-300) along with selected updates conducted in August and October 2014 to obtain information from VA on actions it has taken to address GAO's prior recommendation. For that report, GAO reviewed all 41 major medical leases that were associated with outpatient clinic projects for which a prospectus had been submitted to Congress, as required by law.

What GAO Recommends

In its April 2014 report, GAO recommended that VA update VHA's guidance for the leasing of outpatient clinics. VA concurred with GAO's recommendation and is taking actions to implement the recommendation.

View [GAO-15-723T](#). For more information, contact Dave Wise at (202) 512-2834 or WiseD@gao.gov.

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Actions Underway to Improve the Leasing of Outpatient Clinics

What GAO Found

In its April 2014 report, GAO found that schedules were delayed and costs increased for the majority of the Department of Veterans Affairs' (VA) leased outpatient projects reviewed. As of January 2014, GAO found that 39 of the 41 projects reviewed—with a contract value of about \$2.5 billion—experienced schedule delays, ranging from 6 months to 13.3 years, with an average delay of 3.3 years. The large majority of delays occurred prior to entering into a lease agreement, in part due to VA's Veterans Health Administration (VHA): 1) providing project requirements late or changing them or 2) using outdated guidance. Costs also increased for all 31 lease projects for which VA had complete cost data, primarily due to delays and changes to the scope of a project. For example, first-year rents increased a total of \$34.5 million—an annual cost which will extend for 20 years (the life of these leases).

GAO's report also found that VA had taken some actions to address problems managing clinic-leased projects. First, it established the Construction Review Council in April 2012 to oversee the department's capital asset programs, including the leasing program. Second, consistent with the council's findings and previous GAO work, VA was planning the following improvements:

- *Requiring detailed design requirements earlier in the facility-leasing process.* VA issued a guidance memorandum in January 2014 directing that beginning with fiscal year 2016, VA should develop detailed space and design requirements before submitting the prospectus to Congress.
- *Developing a process for handling scope changes.* In August 2013, VA approved a new concept to better address scope changes to both major construction and congressionally authorized lease projects. According to VA officials, among other improvements, this process ensures a systematic review of the impact of any ad-hoc changes to projects in scope, schedule, and cost.
- *Plans to provide Congress with clearer information on the limitations associated with costs of proposed projects.* VA's 2014 budget submission did not clarify that its estimates for future lease projects included only one year's rent, which does not reflect the total costs over the life of the leases, costs that VA states cannot be accurately determined in early estimates. VA officials clarified this estimate beginning with VA's 2015 budget submission.

However, these improvements were in the early stages, and their success will depend on how quickly and effectively VA implements them.

- Finally, GAO reported that VA was also taking steps to refine and update guidance on some aspects of the leasing process, for example the VA's design guides, but VHA has not updated the overall guidance for clinic leasing (used by staff involved with projects) since 2004. In October 2014, VA reported that it was in the process of revising its clinic leasing guidance in response to GAO's recommendation and that its leasing authority was now under the General Services Administration (GSA) and the handbook was undergoing further revisions to incorporate GSA leasing processes.

Chairman DeSantis, Ranking Member Lynch, and Members of the Subcommittee:

I am pleased to be here today to discuss our work examining schedule delays and cost increases at the Department of Veterans Affairs' (VA) major leased outpatient clinics.¹ VA operates one of the nation's largest health-care delivery systems. To help meet the changing medical needs of the veterans' population, including a greater need for outpatient services, VA has increasingly leased the facilities from which it provides its health care services. VA believes that leasing the Veterans Health Administration's (VHA) medical facilities rather than owning them allows VA to provide more veterans with accessible health-care services and gives it the flexibility to respond to changing service demands, demographic shifts, and improvements in medical technology.²

Depending on the facility's size and scope of services, VA's outpatient clinics can provide primary care; dental care; pharmacy, laboratory, and radiology services; nutritional medicine; women's health care; mental health and suicide prevention services; and other types of specialty care. As of November 2013, VHA's leasing program had a long-term liability of \$5.5 billion and growing with a total of 1,889 leases.³

¹GAO, *VA Real Property: Action Needed to Improve the Leasing of Outpatient Clinics*, [GAO-14-300](#) (Washington, D.C.: Apr. 30, 2014).

²The purpose of our April 2014 report was not to determine whether it is more appropriate for VA to lease versus own facilities. Instead, the report identified changes to schedule and costs of VA's major leasing projects, actions VA has taken to improve its management of these projects, and further opportunities for improving management of the VA's leasing program. Although not addressed in that report, GAO has previously reported on some federal agencies' overreliance on costly leasing, which is one reason that federal real property has remained on GAO's high-risk list. See GAO, *Greater Transparency and Strategic Focus Needed for High-Value GSA Leases*, [GAO-13-744](#) (Washington, D.C.: Sept. 19, 2013).

³According to VA, lease term liability includes long-term VA direct leases and leases that are administered through the General Services Administration. The liability is calculated as the base term, i.e., the number of years for the term of the lease, times the annual rent; however, this calculation does not include past payments. VA has leased 848 of 1,393 total outpatient clinics.

At the time of our work, VA was required to submit a prospectus to Congress for all major medical-facility leases and construction projects.⁴ VHA is responsible for developing the requirements for build-to-suit and remodeled lease facilities.⁵ The Office of Construction and Facilities Management's (CFM) Office of Real Property Service (RPS) is responsible for acquiring land and leasing space for the construction of medical and medically related facilities for VA, and provides guidance to regional and local VA offices regarding real property.⁶

This testimony discusses VA's leasing management issues, specifically:

1. the extent to which schedule and costs changed for selected VA outpatient clinics since they were first submitted to Congress and the factors that have contributed to any changes, and
2. the actions, if any, VA has taken to improve its leasing practices for outpatient clinics and any opportunities that may exist for VA to improve its management of project schedules and costs.

This testimony is based on our April 2014 report on VA's major leased outpatient clinics⁷ along with selected updates conducted in August and October 2014 to obtain information from VA on actions it has taken to address GAO's prior recommendation. In that report, we discuss 41 current major medical leases that are outpatient clinic projects for which a

⁴38 U.S.C. § 8104(b). A prospectus is a statement required to justify a proposed project when its cost exceeds a legislatively established threshold. A prospectus includes information on the project's size, cost, location, and other features and is submitted to the appropriate House and Senate authorizing committees. VA, *Directive 7815: Acquisition of Real Property by Lease and by Assignment from General Services Administration* (Washington, D.C.: January 2012). Generally, VA submits its prospectuses as part of its annual budget submission.

⁵The use of a landlord or developer to construct a building according to VA's requirements is known as a build-to-suit lease. A build-to-suit lease is one type of lease that VA uses for its outpatient clinics and other facilities, in addition to procuring leases in existing space.

⁶VA's process for procuring major leases is two-part: (1) CFM and VHA plan and prepare for a leasing project prior to entering into a lease agreement, and (2) CFM oversees the "build-out" of the leasing project, not the administration of the lease. CFM has the overall responsibility for managing VA's nationwide leasing program, including negotiating and executing development of the lease project. After completion of the facility, VHA activates it to provide medical care.

⁷GAO, *VA Real Property: Action Needed to Improve the Leasing of Outpatient Clinics*, [GAO-14-300](#) (Washington, D.C.: Apr. 30, 2014).

prospectus had been submitted to Congress, as required by law.⁸ The total contract value of these 41 projects is \$2.5 billion.⁹ The prospectuses for these projects were submitted to Congress from 1997 to 2011. We reviewed VA data as of January 2014 on each of these projects. We reviewed and analyzed the original cost estimate and completion date from when a project's prospectus was first submitted to Congress and the project's current status. To examine specific outpatient projects in greater detail, we selected 11 clinic projects in 8 locations: (1) Jacksonville, Florida; (2) Baltimore, Maryland; (3) Las Vegas, Nevada (four facilities);¹⁰ (4) Austin, Texas; (5) McAllen, Texas; (6) Corpus Christi, Texas; (7) Parma, Ohio; and (8) Ft. Wayne, Indiana. We selected these projects and locations based on the following criteria: (1) projects status; (2) project costs; (3) scope and cost changes; and (4) schedule delays.¹¹ We reviewed VA's leasing guidance and directives, VA's *Strategic Plan Fiscal Year 2011 to 2015*, and other relevant documents. In addition, we

⁸38 U.S.C. § 8104. For the purpose of this testimony, when we refer to submitting a prospectus to Congress, we mean submitting the prospectus to relevant congressional committees. VA provided data for its 82 major lease facility projects; however, for the purpose of our April 2014 report, we reviewed VA's outpatient clinics since these facilities are leased by VA. In total, 69 of the 82 leasing projects VA provided data for were outpatient clinics; however, 24 of these outpatient clinics were submitted in VA's fiscal year 2014 budget request and have yet to receive funding. Furthermore, 4 additional outpatient clinic projects were eliminated from our review for the following reasons: (1) Peoria, IL, and Columbus, GA – these facilities were added to VA's budget request as "extra" projects and were not included in VA's official budget submission. As such, a prospectus was never submitted for these projects; (2) Boston, Massachusetts—the procurement for this project was canceled due to lack of competition and has not yet been restarted; and (3) Norfolk, Virginia—this project was not procured. As such, the scope of our review focused on the 41 ongoing outpatient-clinic lease projects for which a prospectus was submitted. The following non-outpatient clinic leases were also excluded from our review: (1) VA's 7 larger health care centers that were recently reviewed as part of a VA Office of Inspector General audit; (2) VA's 5 newly leased research center projects; and (3) one community-care center project.

⁹Total contract value includes annual rent for the duration of the contract (in some cases, 20 years) and build-out costs, which VA pays to the developer as a one-time lump-sum payment once a project is completed. Build-out costs are one-time, lump-sum payments VA makes to developers for special purpose, medically related improvements to buildings when VA accepts the projects as completed.

¹⁰In Las Vegas, Nevada, we visited four clinics that were accepted by VA from September 2011 to January 2012 and interviewed officials from each site.

¹¹We selected projects that were far enough along in the leasing process to have actual or projected scope, cost, and schedule data, a selection process that allowed us to identify projects that experienced changes in scope, cost, and schedule.

reviewed relevant prior GAO reports, Office of Management and Budget guidance on leasing practices, and relevant legislation pertaining to VA's leasing authority and amounts appropriated for these projects. We interviewed VA officials and representatives from private companies involved in VA leasing projects. The work on which this statement is based was conducted from May 2013 to April 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. For a more detailed explanation of our scope and methodology, see the April 2014 report.

Project Delays and Cost Increases for Outpatient Leases Mostly Occurred in the Planning Stages Prior to VA Entering into the Lease Agreement

Project Delays

Our April 2014 report noted that VA has experienced substantial delays in executing new outpatient-clinic lease projects; nearly all of the delays occurred in the planning stages prior to entering into a lease agreement with the developer. Specifically, we found that 39 of the 41 outpatient-clinic projects for which a prospectus was submitted experienced schedule delays,¹² ranging from 6 months to 13.3 years, with an average delay of 3.3 years, while 2 projects experienced schedule time decreases. Our data analysis showed that 94 percent of these delays occurred in the planning stages prior to entering into the lease agreement. For all but one

¹²In this testimony, the term "delay" refers to an increase in the scheduled or actual acceptance date for a major VA outpatient-clinic lease project when compared to the acceptance date identified in the prospectus first submitted to Congress.

of the projects that experienced a delay, the delay occurred during the pre-lease agreement stage. We also compared the length of delays that occurred during the pre-lease agreement stage to the length of delays that occurred once a lease agreement was entered into with the development firm. We found that the average delay during the pre-lease agreement stages for all 41 projects totaled nearly 3.1 years. Conversely, the average project delay once a lease agreement was finalized totaled approximately 2.5 months, and 11 outpatient-clinic projects actually experienced schedule decreases during this stage. VA officials at 6 of the 11 outpatient-clinic projects selected for detailed review mentioned that the large majority of schedule delays occur during the planning stages prior to entering into a lease agreement.

For the 41 lease projects we reviewed, we found that several factors contributed to delays:

- *VHA's late or changing requirements:* According to data we analyzed and VA officials we interviewed, late or changing VHA requirements were the most common reasons for delays. Requirements can pertain to facility size, types of treatment rooms, types of medical equipment, electrical voltage needs, and other details. We found in many instances, either that CFM either did not receive VHA's requirements on time or that VHA changed its requirements during the solicitation of offers,¹³ necessitating a re-design that affected the schedule. In evaluating VA data, we found that 23 of the 41 leasing projects (56 percent) experienced delays because VHA was late in submitting space requirements to CFM, or VHA changed space requirements and thus the scope of the project. For example, the size of the Jacksonville outpatient clinic had increased by 29 percent, and the Austin outpatient-clinic site we visited had increased by 36 percent from the time the prospectuses for these projects were submitted to Congress to the time they were completed.
- *Site Selection Challenges:* In analyzing VA data, we found that 20 of the 41 outpatient-clinic projects we reviewed (49 percent) experienced delays due to difficulties in locating or securing a suitable site. For example, an increase in scope to the Jacksonville project resulted in a larger building design that then required more land. To accommodate

¹³Once a site is selected, VA then develops the schematic design using its design guides and solicitation offers to prospective developers of the facility.

these changes, the landowner worked to acquire additional properties around the already selected site. Although the developer was ultimately successful in obtaining additional land for the project, this process led to delays. According to VA officials, prior to entering into the lease agreement, there were delays associated with difficult negotiations with the developer. However, the officials said that the negotiations resulted in keeping project costs lower. In addition, there were significant environmental clean-up requirements at the site, requirements that needed to be satisfied before construction began. The original site's location was obtained in December 2002, but the larger site was not obtained until December 2009, a delay of 7 years.

- *Outdated Guidance:* At the sites we reviewed, we found that outdated policy and guidelines resulted in challenges for VA staff to complete leasing projects on time. For example, officials from the four Las Vegas outpatient sites we visited stated that VA's policies for managing leases seem to change for each project, creating uncertainty regarding CFM job responsibilities.

Project Cost Increases

In addition to substantial delays, our April 2014 report noted that VA also experienced cost increases to its outpatient-clinic projects when compared to the costs in the projects' prospectuses. VA provided cost data for its outpatient-clinic lease projects in January 2014. For the 31 projects with complete cost data,¹⁴ we found that "total first-year costs," when compared to the prospectus costs, increased from \$153.4 million to \$172.2 million, an increase of nearly \$19 million (12 percent).¹⁵ However, for the 31 projects, the total "prospectus first-year rent" was estimated at \$58.2 million, but the total awarded first-year rent for these projects equaled \$92.7 million as of January 2014, an increase of \$34.5 million (59

¹⁴Of the 41 projects included in our review, 10 projects were not included in our cost analysis. Nine of these projects did not have reported first year rent and "build-out" costs (one-time, lump-sum payments VA makes to developers for special purpose, medically related improvements to buildings) because the projects were not yet awarded to a developer. In addition, the Baltimore clinic project was not included in this analysis because its build-out costs were amortized across multiple years rather than included as a lump sum payment for the first year.

¹⁵"Total first-year cost" is defined as the total of awarded rent and awarded build-out cost, which yields the total amount due to the lessor in the first year of the lease. Prospectus cost is the cost provided by VA in its annual budget submission and represents the total amount estimated to be paid by VA in the first year of the lease (first year's rent and the lump sum payment for special-purpose, medically related improvements).

percent).¹⁶ Such increases in rent have long-term implications for VA, because the department must pay the higher rent over the lifetime of the lease agreement. For example, all 31 VA lease projects included in this cost analysis have lease terms of 20 years, and the increase in rent must be paid for the duration of the contract. Although first year's rents increased for the 31 projects—increasing overall total costs—VA's total "build-out" costs were lower than reported in the projects' prospectuses. Build-out costs are one-time, lump-sum payments VA makes to developers for special purpose, medically related improvements to buildings when VA accepts the projects as completed. VA officials said the decrease in build-out costs from those originally estimated in the prospectuses was due to the national downturn in the commercial real estate market starting in 2008. The downturn created more competition among developers and helped VA realize more competitive pricing on its medical build-out requirements than was anticipated in the prospectuses.

The causes of the total cost increase can be attributed primarily to increases in the projects' awarded first-year rent due to the schedule delays and changes to the design or scope of a project that we discussed previously. Schedule delays can increase costs because of changes in the local leasing market during the period of the delay. Therefore, when VA estimates costs as part of the prospectuses submitted to Congress in the annual budget request, an automatic annual escalation is applied to each project to account for rising costs and market forces that make construction and leased space more expensive over time. VA officials said the escalation ensures that the authorized cost of the project is in line with the realities of the real estate and construction markets. Because VA annually adjusts a project's cost by an increase of 4 percent for each year the project is delayed, project delays directly result in cost increases. Additionally, we found that projects we reviewed increased in total size by 203,000 square feet. Changes in a project's size expand the scope of the project, requiring design changes, which can result in schedule delays, further adding to costs.

¹⁶"Prospectus first-year rent" is defined as the cost provided by VA in its annual budget submission and represents the total amount of rent estimated to be paid by VA in the first year of the lease. Awarded rent (first year) is the rent due to the lessor for the first year of the lease. The amount of rent due is determined by the competitive selection of the lessor and is the amount offered by the lessor as part of its proposal. This is memorialized in the lease when the lease contract is executed.

VA Has Taken Some Actions to Improve Its Leasing-Management Practices for Outpatient Clinics; However, Its Guidance Could Be Improved

Our April 2014 report found that VA has made some progress in addressing issues with its major medical-facilities leasing program. Specifically, in April 2012, VA formed a high level council, the Construction Review Council, to oversee the department's capital asset program, including leasing. Based on the findings of the council and our work for the April 2012 report on VA's major leased outpatient clinics, VA is planning the following improvements to the major medical-facilities-leasing program: requiring detailed design requirements earlier in the design process to help avoid the delays, scope changes, and cost increases.¹⁷ However, these improvements were in the early stages, and their success will depend on how quickly and effectively VA implements them.

- *Requiring detailed design requirements earlier in the facility-leasing process.* VA issued a guidance memorandum in January 2014 directing that beginning with fiscal year 2016, VA should develop detailed space and design requirements before submitting the prospectus to Congress:
- *Developing a process for handling scope changes.* In August 2013, VA approved a new concept to better address scope changes to both major construction and congressionally authorized lease projects. According to VA officials, among other improvements, this process ensures a systematic review of the impact of any ad-hoc changes to projects in scope, schedule, and cost;
- *Plans to provide Congress with clearer information on the limitations associated with costs of proposed projects.* VA's 2014 budget submission did not clarify that its estimates for future lease projects included only one year's rent, which does not reflect the total costs over the life of the leases, costs that VA states cannot be accurately determined in early estimates. VA officials clarified this estimate beginning with VA's 2015 budget submission.

¹⁷VA recognizes that firm design requirements need to be established earlier to help major lease projects avoid delays and cost increases. In our April 2014 report, we found that delays occurred prior to entering into a lease agreement, due in part to changing requirements. To limit the need for making changes to design requirements, VA is moving forward with plans to provide detailed requirements prior to submitting a prospectus to Congress for major construction and lease projects for congressional authorization. During our review in January 2014, VA issued a guidance memorandum directing that beginning with fiscal year 2016, VA would develop more detailed space requirements before a prospectus is submitted to Congress for major construction and major leased projects.

However, we also found that while VA has updated and refined *some* guidance for specific aspects of lease projects—including design guidance for the construction of outpatient clinics—to better support VA’s leasing staff and prevent project delays, it has not updated its VHA guidance for clinic leasing (used by staff involved with projects) since 2004. We reviewed VHA’s 2004 *Handbook 1006.1, Planning and Activating Community-Based Outpatient Clinics*, VHA’s overall guidance for leasing outpatient clinics.¹⁸ This *Planning Handbook* is intended to establish consistent planning criteria and standardized expectations. The *Planning Handbook* is widely used by VA officials and provides important guidance, in particular, clarifying the differing responsibilities of officials and departments and the legal authorities of the leasing process. However, this guidance is out of date and no longer adequately reflects the roles and responsibilities of the various VA organizations involved in major medical-facilities-leasing projects.¹⁹ According to VA officials, the close collaboration of these organizations is necessary for a successful lease project.

As of November 2013, VHA’s leasing program has a long-term liability of \$5.5 billion, but its guidance on outpatient clinics is a decade old and no longer relevant. *Standards for Internal Control in the Federal Government* calls for federal agencies to develop and maintain internal control activities, which include policies and procedures, to enforce management’s directives and help ensure that actions are taken to address risks.²⁰ Such activities are an integral part of an entity’s planning, implementing, reviewing, and accountability for stewardship of government resources and for achieving effective results. The lack of updated guidance can affect coordination among stakeholders and could contribute to schedule delays and cost increases. Using outdated guidance can lead to miscommunications and errors in the planning and implementing of veterans’ leased clinics. Furthermore, the policy, planning criteria, and business plan format in the *Planning Handbook*

¹⁸VA, *VHA’s Handbook 1006.1, Planning and Activating Community-Based Outpatient Clinics*. (Washington, D.C.: May 19, 2004).

¹⁹The guidance makes no specific reference to Office of Construction and Facilities Management or Real Property Services, whose officials play an instrumental role in working with VHA to plan and execute the lease agreement.

²⁰GAO, *Standards for Internal Control in the Federal Government*, AIMD-00-21.3.1 (Washington, D.C.: Nov. 1, 1999).

were developed based on an old planning methodology²¹ that VA no longer uses; thus, the guidance does not reflect VA's current process.²²

In our April 2014 report, we recommended that the Secretary of Veterans Affairs update VHA's guidance for leasing outpatient clinics to better reflect the roles and responsibilities of all VA staff involved in leasing projects. VA concurred with our recommendation and reported that it had created a VHA Lease Handbook that was in the concurrence process to address the roles and responsibilities of staff involving in leasing projects. In October 2014, VA reported that it had revised its clinic leasing guidance in response to GAO's recommendation and that its leasing authority was now under the General Services Administration (GSA) and the handbook was undergoing further revisions to incorporate GSA leasing processes.

Chairman DeSantis and Ranking Member Lynch, and Members of the Subcommittee, this completes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

If you have any questions about matters discussed in this testimony, please contact Dave Wise, (202) 512-2834 or Wised@gao.gov. Other key contributors to this testimony include Ed Laughlin, Assistant Director; Nelsie Alcoser; George Depaoli; Jessica Du; Raymond Griffith; Amy Rosewarne; and Crystal Wesco.

²¹The Capital Asset Realignment for Enhanced Services' planning methodology.

²²VA now uses Strategic Capital Investment Planning (SCIP) process for its infrastructure planning. As part of this planning effort, VA annually reviews its real property priorities and conducts a gap analysis to identify its need for medical facilities. The SCIP process includes major construction projects and leasing projects. Local plans are centrally validated, evaluated, and consolidated into a prioritized national project list. VA also uses this planning process to develop a 10-year long-range plan, which prioritizes a list of projects targeted to reduce service gaps.

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