

Federal Housing Finance Agency  
Office of Inspector General



**Special Report: Update on FHFA's  
Oversight of Fannie Mae's Build-Out  
of its Newly Leased Class A Office  
Space in Midtown Center**

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## Executive Summary

In June 2016, the Federal Housing Finance Agency (FHFA) Office of Inspector General (OIG) issued a *Management Alert* in which we reported the findings of our inquiry into an anonymous hotline complaint alleging excessive spending by Fannie Mae on its consolidation and relocation of offices. That inquiry focused primarily on FHFA's oversight of Fannie Mae's plans to build-out its newly leased Class A office space in the Midtown Center building owned by Carr Properties LLP (Landlord) and attendant costs.

We learned that the project's build-out costs had risen dramatically from \$115 million, when the Agency approved the project in January 2015, to \$171 million in March 2016, and that the plans for it included high-end features (hereinafter, upgrades), such as multimillion dollar glass walkways between the towers Fannie Mae would occupy. We also ascertained that the FHFA official responsible for overseeing the build-out was unaware of the escalating costs. Accordingly, we found that the projected cost of the build-out presented significant financial and reputational risks that warranted "immediate, sustained, and comprehensive oversight" from FHFA, Fannie Mae's conservator.

We found that such oversight by Fannie Mae's conservator required it to determine whether the efficiencies of the upgrades specified by Fannie Mae justified their estimated costs, and whether such upgrades were cost-effective or appropriate for an entity in a federal conservatorship with an uncertain future to install in leased commercial space. In our view, that standard was consistent with FHFA's statutory duties, as conservator, to "preserve and conserve the assets and property" of Fannie Mae, pursuant to 12 U.S.C. § 4617(b)(2)(B)(iv).

To assist the Agency in making this determination we made two specific recommendations. In response, the Agency did not challenge, or object to, our finding that it review the efficiencies of specific upgrades against their costs and determine whether they were "appropriate for an entity in conservatorship." FHFA remarked that it was "well aware" of the risks associated with this project and commented that our recommendations could facilitate its efforts "to provide more rigorous and appropriate oversight throughout the construction process." The Agency accepted our recommendations and committed to "implement them to the extent that [it was] not already doing so."

We conducted this review to determine how FHFA, in its capacity as Fannie Mae's conservator, has overseen the build-out of Fannie Mae's new headquarters over the past year.



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Since the issuance of our *Management Alert*, FHFA established a four-member committee (Committee), reporting to the Acting Deputy Director for the Division of Conservatorship (DOC). According to the Acting Deputy Director of DOC (Acting Deputy Director), DOC is not staffed with a sufficient complement of employees to assess the reasonableness of each of Fannie Mae's proposed upgrades. FHFA retained a consulting engineering firm (expert) to conduct a value engineering and benchmarking study, assist the Committee with design of a monthly dashboard report, and respond to questions from the Committee.

FHFA did not provide its expert with a standard with which to conduct its study that reflected Fannie Mae's status as an entity in federal conservatorship with an unknown future. Instead, it directed its expert, in its Statement of Work, to compare the project design activities and costs to industry and government benchmarks and propose multiple benchmarks for FHFA to select from. Committee members reported that FHFA's expert reviewed Fannie Mae's build-out plans and met with Fannie Mae representatives and reported to the Committee that the collaborative workspace proposed by Fannie Mae was in line with corporate America and that Fannie Mae was "doing it the right way." After discussions with the Committee, FHFA's expert proposed this standard: whether the upgrades specified by Fannie Mae were reasonable when compared against the upgrades selected by major financial institutions and large public sector agencies, including FHFA, for their space. Committee members explained that Fannie Mae's largest asset was its human capital and that the proposed standard reflected that Fannie Mae, as a large financial institution, needed to attract and retain highly qualified employees and competed against other large financial institutions for the same talent pool. The Committee endorsed and FHFA approved the expert's proposed standard.

Using that standard, FHFA's expert performed its benchmarking study. During the course of the expert's study, Committee members reported to us that they discussed the reasonableness of some of the larger and more significant upgrades with the expert under the agreed-upon standard. In March 2017, FHFA's expert reported, in writing, that specific categories of upgrades were reasonable. Those categories included:

- \$7.7 million for interior finishes and detailing of a "very high level of quality";
- \$4.1 million for a cafeteria, which FHFA's expert cautioned could be underutilized because of numerous nearby dining opportunities;



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- \$2.1 million for “light-filled” Town Centers, which FHFA’s expert opined would “provide a much-needed sense of openness and day lighting, necessary for human interaction and productivity”;
- \$2 million for an additional glass bridge spanning the space between the two towers that comprise the Midtown Center, which Fannie Mae justified on the grounds that it would “further enhance the interconnectivity across nearly all its floors...” and “...allow[] for the ability to bring external visitors and customers through the office space on a ‘journey’ of Fannie Mae”;
- \$3 million for additional generator support that according to its expert, exceeded comparable benchmarks; and
- \$700,000 for an audio-visual (broadcast) studio which Fannie Mae claimed was required to conduct its business.

The Committee and representatives of FHFA’s expert briefed the FHFA Director and senior FHFA executives on the results of the expert’s benchmarking study on March 9, 2017. According to participants at that briefing, FHFA executives asked questions about the reasonableness of certain of these categories of upgrades. At the conclusion of this briefing, the FHFA Director did not object to these categories of upgrades, which the expert estimated would cost about \$32 million above the costs to build-out typical Class A space in the Washington, D.C. area.

The expert’s report did not address the reasonableness of upgrades that were not included in these categories and neither did the Committee. According to the Acting Deputy Director, FHFA delegated to Fannie Mae the management of the build-out, and counted on Fannie Mae to keep the Committee informed of the decisions that it was making. Committee members reported to us that the Committee determined that Fannie Mae was better able to select appropriate features and finishes, and relied on Fannie Mae to make those selections. They advised that the Committee did not review the reasonableness of individual upgrades not discussed in the expert’s report. According to Committee members, they conducted oversight by reviewing Fannie Mae’s high-level budget and progress reports with FHFA’s expert.

In our view, that standard used by FHFA and its expert – whether the upgrades selected by an entity in federal conservatorship were reasonable when compared to the upgrades in the headquarters of major financial institutions and large public sector agencies, including FHFA – is inconsistent with FHFA’s statutory duties, as conservator, to “preserve and conserve the assets and property” of Fannie Mae, pursuant to 12 U.S.C.



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§ 4617(b)(2)(B)(iv). Fannie Mae has been under the conservatorship of FHFA since September 2008 and its future is uncertain. It has leased space in a brand-new Class A building in downtown Washington, D.C., and FHFA's expert has determined that the industry baseline to build-out similar space is approximately \$175 per rentable square foot (RSF). The upgrades specified by Fannie Mae "over and above" Class A space total at least \$32 million and may be significantly higher. For example, the expert's report does not specifically discuss \$9.6 million for items identified in the General Contractor's June 21, 2017, budget, such as "bars, and quartz and glass countertops" in a wellness room, town center café, and a "CC lounge," free-standing decorative wood "lunch huts", "custom wood menus for the Sky lobby café, and elevator lobby pergolas." Neither does the report mention architectural design features, rendered in metal and wood, that are also included in this General Contractor's budget. We are not able to determine the total cost of these architectural design features from the General Contractor's budget. Based on the information provided to us during our fieldwork, we could not determine whether FHFA's expert or its Committee ever reviewed them or whether all or part of the \$9.6 million is included in the \$175 per RSF or the expert's \$32 million projected cost of upgrades "over and above typical Class A space." Because FHFA has not determined, as conservator, whether any, or all, of the individual upgrades "over and above" Class A space are appropriate expenditures for an entity in conservatorship with an uncertain future to install in leased commercial space, we question the costs for all upgrades above \$175 per RSF to Fannie Mae's leased Class A space.

Richard Parker  
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## ABBREVIATIONS .....

Agency or FHFA	Federal Housing Finance Agency
DOC	Division of Conservatorship, FHFA
Fannie Mae	Federal National Mortgage Association

## BACKGROUND.....

In 2012, Fannie Mae began work to develop a long-term solution to its workspace needs in the metropolitan Washington, D.C. area: thousands of its employees worked in numerous locations, some of which were owned by Fannie Mae and some of which were leased. After study of several options, Fannie Mae management concluded that its best option would be to consolidate all operations in the Washington, D.C. area into a single facility.

In January 2015, the Fannie Mae Board of Directors approved the consolidation and relocation of Fannie Mae’s Washington, D.C. area offices into approximately 700,000 square feet of leased space in a new building, Midtown Center, to be built on the former Washington Post site. On January 22, 2015, FHFA, Fannie Mae’s conservator, rescinded the authority it previously delegated to Fannie Mae to decide whether and where to consolidate its metro D.C. area offices and the total net present value of the monies to be spent on any such consolidation and relocation. One week later, FHFA authorized Fannie Mae to proceed with the relocation project and execute a 15-year lease, which provided for the build-out and occupancy of space in Midtown Center.<sup>1</sup>

***OIG Management Alert: Significant Financial and Reputational Risks from the Escalating Build-out Costs for Fannie Mae’s Newly Leased Space Warranted Immediate, Sustained and Comprehensive Oversight from FHFA, Conservator of Fannie Mae***

After we received an anonymous hotline complaint alleging, among other things, excessive spending by Fannie Mae on its consolidation and relocation of offices, we began a review that focused primarily on FHFA’s oversight of Fannie Mae’s plans to build-out its newly leased space in Midtown Center and its attendant costs.<sup>2</sup>

When FHFA approved the project in January 2015, Fannie Mae projected its build-out costs to be \$164.32 per square foot. Of that \$164.32, its Landlord agreed to pay \$120 per square foot through a tenant improvement allowance, and Fannie Mae was responsible for the remaining \$44.32 per square foot. Given that the amount of leased space was planned at

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<sup>1</sup> For a fulsome discussion of the history of the consolidation and relocation project and the terms of Fannie Mae’s lease for Midtown Center, *See Management Alert: Need for Increased Oversight by FHFA, as Conservator of Fannie Mae, of the Projected Costs Associated with Fannie Mae’s Headquarters Consolidation and Relocation Project*, COM-2016-004 (June 16, 2016) (*Management Alert*, COM-2016-004).

<sup>2</sup> We subsequently conducted an inquiry and issued a Management Alert on the escalating costs of Fannie Mae’s build-out of leased space in an office building in Plano, Texas into which it was consolidating its offices in the Dallas metropolitan area. *See Fannie Mae Dallas Regional Headquarters Project*, OIG-2017-002, December 15, 2016.

700,000 square feet, the projected build-out costs were \$115 million (700,000 x \$164.32) of the project's total 15-year net present value of \$770,481,598. During our review, we learned that the projected costs of the build-out rose from \$164.32 per square foot, in January 2015, to \$252.81 per square foot in March 2016, an increase of \$88 per square foot—or 53.85%. We reported that, by May 2016, the build-out costs were projected at \$235.35 per square foot, of which Fannie Mae was responsible for \$115.35 per square foot.

We identified significant financial and reputational risks from the escalating projected costs associated with Fannie Mae's build-out of its leased space stemming from the following factors: the build-out costs had risen dramatically; FHFA did not know the extent to which proposed upgrades in Fannie Mae's plans could be altered, or what costs might be attendant upon the removal of proposed upgrades that were not approved by the Agency; Fannie Mae was in federal conservatorship, and its future could not be predicted; and Fannie Mae arguably had little incentive to cabin its build-out costs for its leased space because any positive net worth it did not spend on itself would be swept into the Treasury as a dividend.

In light of these risks, we concluded that immediate, sustained, and comprehensive oversight from FHFA, conservator of Fannie Mae, was warranted. Accordingly, we determined that FHFA needed to

- “[A]ssess the anticipated efficiencies of specific proposed features against the estimated costs of those features and determine whether the efficiencies warrant the costs.” and
- “[D]etermine whether the proposed features for leased space in a building that is not owned by Fannie Mae or the U.S. government are appropriate for an entity in conservatorship.”

To assist FHFA in providing “immediate, sustained comprehensive oversight,” we made two specific recommendations. First, that the Agency ensure that it had adequate internal staff, outside contractors, or both, with professional expertise in commercial construction to oversee the build-out plans and associated budgets as Fannie Mae revised and refined them. Second, that the Agency receive from Fannie Mae regular updates and formal budgetary reports on the build-out for its review and approval.

#### ***FHFA's Response to Our Management Alert***

By Memorandum dated July 13, 2016, FHFA offered “context” to be included with the *Alert*. It observed that decisions about the cost of certain features specified by Fannie Mae “almost always involves tradeoffs between up-front costs and longer-term operating costs and efficiencies.” It noted, for example, that features such as glass bridges, spiral staircases, and Town Centers “are an essential part of the new ‘open-office’ design concept that has proven

to both save space and encourage employee collaboration and efficiency.” The Agency reported that there were “numerous other options under consideration that will require difficult decisions that balance their up-front cost against their longer-term benefits.” In providing this context, FHFA appeared to endorse our finding that it was required to assess the anticipated efficiencies of specific proposed features against the estimated costs of those features and determine whether the proposed features for leased space in a building that is not owned by Fannie Mae or the U.S. government were appropriate for an entity in conservatorship. FHFA commented that our recommendations could facilitate its efforts “to provide more rigorous and appropriate oversight throughout the construction process” and committed to “implement them to the extent that [it was] not already doing so.”

## FACTS AND ANALYSIS .....

To assist FHFA in providing “immediate, sustained comprehensive oversight,” we made two specific recommendations in our *Management Alert*. First, that the Agency ensure that it had adequate internal staff, outside contractors, or both, with professional expertise in commercial construction to oversee the build-out plans and associated budgets as Fannie Mae revised and refined them. Second, that the Agency receive from Fannie Mae regular updates and formal budgetary reports on the build-out for its review and approval.

Consistent with its commitment to implement the recommendations in our *Management Alert*, FHFA established a four-member Committee reporting to the Acting Deputy Director and retained an outside expert to conduct a value engineering and benchmarking study. We interviewed all four members of the Committee.

### Oversight Efforts by the Committee

In January 2015, Fannie Mae’s Board approved a recommendation from Fannie Mae management to consolidate and relocate its offices in the D.C. metropolitan area to leased space in Midtown Center. A Committee member explained that Fannie Mae proposed to move from a traditional office configuration, where most employees had their own offices, to a collaborative “open space” office configuration, with fewer (and smaller) individual offices and intense use of collaborative space. On January 22, 2015, FHFA, Fannie Mae’s conservator, rescinded the authority it previously delegated to Fannie Mae to decide whether and where to consolidate its metro D.C. area offices and the total net present value of monies to be spent on any such consolidation and relocation. One week later, FHFA authorized Fannie Mae to proceed with the relocation project and execute a 15-year lease, which provided for the build-out and occupancy of space in Midtown Center. According to the Acting Deputy Director, FHFA delegated to Fannie Mae the management of the build-out,

and counted on Fannie Mae to keep the Committee informed of the decisions that it was making.

Committee members provided additional context for FHFA's decision to delegate responsibility for the build-out to Fannie Mae. Some members of the Committee advised that Fannie Mae's proposed consolidation of its offices into leased space at Midtown Center would shrink its existing footprint, which was in the best interests of the American taxpayer, and would change its work environment from offices to collaborative workspaces.<sup>3</sup> They explained that the U.S. mortgage market is the second largest financial market in the world and Fannie Mae needs to recruit and retain highly qualified individuals for its employee base. They reported that Fannie Mae claimed that its office space and amenities had to be designed to attract such individuals and to keep up morale of its existing employees, especially in light of its decision to change its office culture to collaborative work spaces with many fewer, smaller offices. Committee members also related that Fannie Mae's most important human asset is its human capital and that it was appropriate for FHFA, as conservator, to delegate to Fannie Mae responsibility to create a work space that would convey stability and attract and retain the kind of talent Fannie Mae needs. Even if Fannie Mae did not emerge from conservatorship to play an important role in a redesigned housing finance system, the Committee advised us that, in their view, Fannie Mae's well-appointed space would be easier to lease to other tenants.

The Acting Deputy Director represented that DOC is not staffed with a sufficient complement of employees to conduct assessments of individual upgrades and that the Committee was not asked to make those assessments. His view was seconded by Committee members who reported that it was not the committee's job to review or approve individual upgrades specified by Fannie Mae in the build out. One Committee member represented there was "no way" for the Committee to evaluate "little" things, such as potentially expensive features and finishes from a "conservatorship" perspective, noting that such features were consistent with those used in large financial institutions. Instead, Committee members advised that such determinations were committed to Fannie Mae's discretion by the Agency. By way of example, the Acting Deputy Director explained that Fannie Mae's Board of Directors could work just as well in a room finished in painted drywall, rather than in high end wood finishes, but that the Committee was not in the business of questioning individual upgrades. Because the current estimate of Fannie Mae's build-out of its leased space is \$150 million, Committee members opined to us that any concern with small upgrades, constituting a "fraction" of the

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<sup>3</sup> According to Fannie Mae, its consolidation and relocation effort will: reduce its footprint from 991,000 square feet of space in owned and leased space in the metropolitan D.C. area to 679,000 square feet in one location; reduce the number of individual employee offices by 80 percent; reduce the size of individual executive offices by more than 50 percent; and improve employee productivity by consolidating its metropolitan D.C. workforce into one location. [www.fanniemae.com/portal/media/statements/2016/relocation-dc-faqs-statement-121516-6498.html](http://www.fanniemae.com/portal/media/statements/2016/relocation-dc-faqs-statement-121516-6498.html).

build-out costs, would be myopic. They reported that FHFA took the same approach with the build-out as it did on most conservatorship items: it did not “micromanage.” One Committee member said the goal was not to get to that level of detail.

The Acting Deputy Director reported that the Committee obtained a monthly formal dashboard report, designed by FHFA’s expert, and populated by Fannie Mae. We reviewed these dashboard reports and found that they contained no information about the details of individual upgrades specified by Fannie Mae or their cost. According to the Acting Deputy Director, these dashboard reports did not go into that level of detail “by design.” He underscored that it was not the committee’s job to review or approve individual upgrades specified in the build-out, and that FHFA interpreted its agreement to “approve” the monthly reports as limited to review by DOC’s committee. He maintained that this Committee limited its scope to objecting to upgrades brought to its attention that it thought could be “out of line.”

Committee members confirmed that the monthly reports (which lagged 30 days after the close of the month) focused on budget and timeline, rather than on the costs of individual upgrades.

### **Benchmarking by FHFA’s Expert**

In mid-2016, FHFA engaged an expert to conduct a benchmarking study of Fannie Mae’s build-out plans for its leased space in Midtown Center.<sup>4</sup> According to Committee members and FHFA’s expert, the benchmarking study was not designed to determine whether the upgrades specified by Fannie Mae were cost-effective or could be obtained at a lower cost. Committee members reported that Fannie Mae did not provide data to demonstrate either that the efficiencies obtained from particular upgrades warranted their cost over time or that an investment in specific upgrades would lead to future savings. Instead, they reported that Fannie Mae viewed the build-out of its space more holistically: what upgrades were needed to make the smaller footprint of the newly leased space, where most employees were expected to work collaboratively in common areas, sufficiently attractive to recruit and retain employees.<sup>5</sup>

FHFA did not provide its expert with a standard with which to conduct its study that reflected Fannie Mae’s status as an entity in federal conservatorship with an unknown future. Instead,

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<sup>4</sup> The expert was also tasked with assisting the Committee with the design of a monthly dashboard report, and responding to questions from the Committee.

<sup>5</sup> On its website, Fannie Mae offers the following explanation for some of its upgrades. It reports that upgrades with “higher up-front costs were chosen in order to achieve even greater reductions in the operating cost of the space over the life of our occupancy. For instance, Fannie Mae selected LED lighting, which is more expensive initially than fluorescent lighting, because it is significantly cheaper to operate. Similarly, Fannie Mae selected mechanical shades and a DOAS mechanical system to reduce our heating and cooling costs.”

[www.fanniemae.com/portal/media/statements/2016/relocation-dc-faqs-statement-121516-6498.html](http://www.fanniemae.com/portal/media/statements/2016/relocation-dc-faqs-statement-121516-6498.html).

it directed its expert, in its Statement of Work to compare the project design activities and costs to industry and government benchmarks and propose multiple benchmarks for FHFA to select from. Committee members reported that FHFA’s expert reviewed Fannie Mae’s build-out plans and met with Fannie Mae representatives and reported to the Committee that the collaborative workspace proposed by Fannie Mae was in line with corporate America and that Fannie Mae was “doing it the right way.” After discussions with the Committee, FHFA’s expert proposed this standard: whether the upgrades specified by Fannie Mae were reasonable when compared against the upgrades selected by private sector major financial institutions, and large public sector agencies, including FHFA for their space.<sup>6</sup> Committee members explained that Fannie Mae’s largest asset was its human capital and that the proposed standard reflected that Fannie Mae, as a large financial institution, needed to attract and retain highly qualified employees and competed against other large financial institutions for the same talent pool. The Committee endorsed and FHFA approved the expert’s proposed standard.

Using that standard, FHFA’s expert performed its benchmarking study. Committee members reported that the Committee met regularly with the expert during the course of the benchmarking study and discussed the reasonableness of some of the larger and more significant upgrades against the agreed-upon standard. In its management response, FHFA states that “FHFA and our expert evaluated the appropriateness and cost-effectiveness of the major upgrades.” Respectfully, we must disagree, based on the information learned during our fieldwork for this report: we were advised, during our interviews of Committee members and FHFA’s expert, that they did not review whether any of the major upgrades were cost-effective or whether lower cost alternatives were available.

Committee members and a representative of FHFA’s expert reported to us that their regular discussions focused only on the reasonableness of some of the larger upgrades, and did not include the reasonableness of individual items, such as specific finishes and features.<sup>7</sup> For

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<sup>6</sup> According to a representative of FHFA’s expert, there was no headquarters space in the Washington, D.C. area comparable to Fannie Mae’s plans for its leased space in Midtown and, accordingly, its benchmarking standard was tied to major financial institutions and large public sector agencies.

<sup>7</sup> For example, we identified an upgrade in the 80% General Contractor construction design documents identified as a \$250,000 chandelier. The expert’s representative explained that the expert first thought it was a light fixture but learned later that it was an “architectural feature” for the trading room, intended to “evoke” the activity in that room and assumed that this feature was part of some “government art program.”

Subsequently, Fannie Mae “informed” FHFA that it had elected to eliminate two “architectural” design elements. One of those design elements, a “hanging key sculpture” intended for the visitor lobby, was budgeted at \$150,000 and had a current estimate of \$95,000. The second, decorative screens, intended for a conference room in a town center, was budgeted at \$985,000 and had a current estimate of \$500,000. According to Fannie Mae, it decided to remove both “architectural elements [it] had designed” into Midtown Center because of “concern[s] that they could create an unwarranted perception of our efforts to execute our

example, Fannie Mae sought to install additional generator support to its operations at a cost of \$3 million.<sup>8</sup> The expert concluded that “[t]his level of generator backup exceeds comparable benchmark facilities.” The expert’s report states that Fannie Mae appeared to exercise its due diligence in making its decision to include additional generator support, but noted that evaluation of this “business decision is beyond the scope of this study” other than to say that “it appears due diligence was performed.” One Committee member reported that there were other ways to ensure a consistent supply of power such as tapping into power from different sources. Committee members acknowledged that Fannie Mae provided no mathematical analysis to support the reasonableness of its need for additional generator support (or for other larger and more significant upgrades that it sought). Committee members stated that Fannie Mae provided its justification for the additional generator support: its need to maintain a constant source of power at all times once its Washington, D.C. offices were consolidated into one location. In the end, both the Committee and FHFA’s expert found the additional generator support to be reasonable.

Similarly, Committee members recalled discussions with FHFA’s expert about the reasonableness of the third bridge proposed by Fannie Mae, which Fannie Mae contended would increase the efficiency of employees and improve workflow. One Committee member reported that he visited the site, walked around the horseshoe and concluded that a third bridge would improve efficiency. He explained that FHFA’s expert viewed the third bridge as a reasonable upgrade because Fannie Mae employees would be located in two towers and the third bridge would increase employee efficiency and would be good for workflow. The Committee discussed both the site visit and the proposed increase in efficiency, and accepted Fannie Mae’s justification for the third bridge.

The expert and the Committee concluded that these larger and more significant upgrades were reasonable against the agreed-upon standard. Committee members acknowledged that their discussions did not assess the efficiency of such upgrades against their costs or determine the appropriateness of such upgrades for an entity in federal conservatorship with an uncertain future. For each of the larger and more significant upgrades considered, Committee members reported that the Committee and FHFA’s expert ultimately accepted the justification offered by Fannie Mae. Committee members reported to us that the Committee never suggested that it eliminate any of these upgrades or find a less costly alternative.

In early March 2017, FHFA’s expert submitted its report to DOC. It explained that it first established the build-out costs for commercial Class A leased space in Washington D.C.,

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workplace strategy in the best interest of the taxpayer.” It emphasized that it had “chosen to remove” both elements, currently estimated at \$595,000.

<sup>8</sup> According to the expert’s report, Fannie Mae’s upgrades include increasing the load capacity of the base building generator and adding two additional standby generators.

defined as the “most prestigious buildings competing for premier office users with rents above average for the area.”<sup>9</sup> Adjusting the “the current industry baseline” to reflect the size and schedule of Fannie Mae’s build-out, the expert set the benchmark for building-out Class A space in Washington, D.C. at approximately \$175 per RSF.<sup>10</sup> Next, the expert identified Fannie Mae’s upgrades “over and above Class A” space—including the sort of upgrades we brought to FHFA’s attention in our Management Alert—and found that they were “not typical for Class A” space. The expert’s report discussed specific categories of upgrades and concluded that each was reasonable for inclusion in the headquarters of a major financial institution and large public sector agencies, including FHFA. Those categories included:

- \$7.7 million for interior finishes and detailing, which FHFA’s expert found to be at a “very high level of quality, particularly with respect to finishes in the circulation and collaboration spaces.” which was “over and above” typical Class A space. Included in these finishes and detailing were “wood veneer finishes” (\$2,500,000), “decorative wood slatted ceilings” (\$1,200,000), format tile for “core wall elevations” (\$750,000), and “gypsum ceiling detailing” (\$540,000). FHFA’s expert noted that the level of detailing was “pretty intense” and in the realm of “high end design.” It concluded, however, that these features and finishes were “consistent with those found in major financial institutions or law firms and may be instrumental in attracting future employees to Fannie Mae” and were “reasonable enhancements.”

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<sup>9</sup> The Building Owners and Managers Association (BOMA) classifies office space into three categories, Class A, Class B, and Class C, and publishes definitions for each building class. This definition of Class A space is the one developed by BOMA. According to BOMA, Class A buildings “have high quality standard finishes, state of the art systems, exceptional accessibility and a definite market presence.”

<sup>10</sup> In Appendix 2 of its report, the expert included CBRE’s guide of the “average” cost to build-out Class A space per square foot in a number of U.S. cities, including Washington, D.C. According to CBRE, the average cost in Washington, D.C. is \$162.02 per square foot.



- \$4.1 million for a cafeteria, which FHFA’s consultant cautioned could be underutilized because of numerous nearby dining opportunities. It considered the factors favoring and disfavoring a cafeteria, such as hoteling, in Fannie Mae’s leased space and found it “right on the cusp.” Fannie Mae explained that visitors would use the cafeteria and take advantage of its work spaces and FHFA’s expert concluded that a cafeteria was “appropriate” for a corporate or government headquarters.



- \$2.1 million for “light-filled” Town Centers, which FHFA’s expert opined would provide a much-needed sense of openness and day lighting, necessary for human interaction and productivity”. Its expert found that these “light-filled” Town Centers compared well to a “collaborative space” in the Capella Tower “in the heart of downtown Minneapolis that provides innovative spaces for collaboration and concentration.”<sup>11</sup> The Capella Tower was designated the 2015 “Building of the Year” by BOMA International. According to FHFA’s expert, the “newly opened space” from the Town Centers “is now a significant factor in the leasing and re-leasing” of Midtown Center.

<sup>11</sup> The planned cylindrical hanging structure inside the circular staircase is no longer a part of the features of the building. See footnote 7.



- \$2 million for a third glass bridge spanning the space between the two towers that comprise the Midtown Center. FHFA’s expert accepted the justification provided by Fannie Mae that, given the existence of two connecting bridges on floors 13 and 11, a third bridge on floor 9 would, “further enhance the interconnectivity across nearly all its floors...” and “...allow[] for the ability to bring external visitors and customers through the office space on a ‘journey’ of Fannie Mae which begins in their visitor lobby, paths through the market room and other vibrant areas, and eventually ends in the conference center.”



- \$ 3 million for additional generator support, despite the expert’s conclusion that “[t]his level of generator backup exceeds comparable benchmark facilities”; and
- \$700,000 for an audio-visual (broadcast) studio which included “a whisper room, control room, server room, track for green screen, workstations, special lighting and IT infrastructure.” Accepting Fannie Mae’s claim that it required an audio-visual studio to conduct its business, FHFA’s expert concluded that the studio was “reasonable given [Fannie Mae’s] programmatic requirement.”

The expert estimated in its report that these and other larger upgrades would add approximately \$46 per RSF to the \$175 per RSF to build-out Class A space in the Washington, D.C. area, making the benchmark \$221 per RSF. The expert projected that the upgrades would add approximately \$32 million to the typical costs to build-out Class A leased space.<sup>12</sup>

<sup>12</sup> FHFA’s expert reported to us that it used the estimated costs used by Fannie Mae’s General Contractor at a point in time when 80% of the design for the build-out was completed.

FHFA's expert met with FHFA's Conservatorship Committee, which includes FHFA's Director, on March 9, 2017, to present its benchmarking report. During that meeting, the Conservatorship Committee reviewed a PowerPoint presentation prepared by the Committee in conjunction with FHFA's expert to discuss the issues covered in the expert's written report, including the proposed significant upgrades and the expert's determination of the reasonableness of each of those upgrades. Committee members reported to us that one purpose of this briefing was to ensure that the FHFA Director understood how Fannie Mae could shrink its footprint and remain efficient and how some of the proposed upgrades would enable Fannie Mae to transition from a culture of individual offices to one of collaborative work spaces and many fewer (and smaller) offices.

Committee members recalled that the FHFA Director and FHFA executives asked questions during the presentation about specific upgrades discussed in the expert's report and that they came away with the impression that the FHFA Director and FHFA executives were satisfied with the explanations provided. Committee members reported that FHFA executives, including the FHFA Director, would have raised objections had they not been satisfied with the explanations.

Had FHFA been dissatisfied with an explanation for one or more of the upgrades, a representative of FHFA's expert explained that it might have been possible to remove the upgrade. For example, the representative explained some of the \$7.7 million in high end finishes could have been eliminated, although those finishes would have been replaced with something else, which could have resulted in delays to the build-out and other costs. In his view, other upgrades, like the third connecting bridge, could probably have been eliminated because fabrication had not begun. For others, like the Town Centers, he opined that it would have been "hard to stop the train."

### **Additional Finishes and Features Not Discussed in FHFA's Expert Report**

We obtained the General Contractor's June 21, 2017, budget estimating the cost of building finishes, at a point in time when 100% of the design for the build-out was completed. Our review of this budget identified approximately \$9.6 million for numerous items, including cabinets in a copy room, pantries, wood doors, bars, and quartz and glass countertops in a wellness room, town center café, and a "CC lounge;" free-standing decorative wood "lunch huts," custom wood menus for the Sky Lobby café, and elevator lobby pergolas. These items are not discussed specifically in the report issued by FHFA's expert. When interviewed, no one with whom we spoke at FHFA – the Committee members or the Acting Deputy Director – could explain whether the costs for these items were included in the \$175 per RSF benchmark or were included in, or in addition to, the expert's projected costs of \$32 million for upgrades "over and above typical Class A space."

In its technical comments to a draft of this report, FHFA asserts that “a portion of this \$9.6 million is included in the \$32 million” in upgrades in excess of the \$175 per RSF and a portion “fall within the Class A standard cost” of \$175 per RSF. Based on the information provided to us during our fieldwork, we could not determine whether FHFA’s expert or its Committee ever reviewed them or<sup>13</sup> whether all or part of the \$9.6 million is included in the \$175 per RSF or the \$32 million. We also identified architectural design features, rendered in metal and wood, in this budget that are not specifically mentioned in the expert’s report. We are not able to determine the total cost of these architectural design features from this budget and we do not know whether FHFA is aware of the costs of all these features.<sup>14</sup>

## QUESTIONED COSTS AND CONCLUSION .....

As conservator, FHFA has a statutory duty to “preserve and conserve the assets and property” of Fannie Mae, pursuant to 12 U.S.C. § 4617(b)(2)(B)(iv), and FHFA recognizes that its ultimate responsibility is non-delegable. In our *Management Alert*, we did not question FHFA’s decision to approve consolidation and relocation of Fannie Mae’s Washington, D.C. offices into newly-built Class A space. In this *Special Report*, we do not question the need for Fannie Mae to spend \$175 per RSF in upgrades to this newly-leased space, which FHFA’s expert set as “the current industry baseline” to build-out class A space.

Instead, we found in our *Management Alert* that the escalating projected costs for Fannie Mae to build out its newly leased Class A commercial space – which were approaching \$235.35 per square foot in May 2016 – warranted immediate, sustained, comprehensive oversight from FHFA, as conservator of Fannie Mae.

We found that such oversight by FHFA, as Fannie Mae’s conservator, required it to determine whether the efficiencies of the upgrades specified by Fannie Mae justified their estimated

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<sup>13</sup> By way of example, an upgrade identified in the 80% General Contractor construction design documents as a \$250,000 chandelier. We asked both the Acting Deputy Director of DOC and the expert’s representative about this. The expert’s representative explained that the expert first thought it was a light fixture but learned later that it was an “architectural feature” for the trading room, intended to “evoke” the activity in that room, and the cost of this feature was not included in its benchmark. The Acting Deputy Director reported to us that he was unaware of this feature or its cost, but that he would question the expenditure of \$250,000 for a piece of art. We found no evidence, however, that FHFA has ever challenged this expenditure. After our interviews of the Acting Deputy Director and FHFA’s expert, we learned that Fannie Mae “informed” FHFA that it had elected to eliminate two “architectural” design elements. See footnote 7.

<sup>14</sup> FHFA’s expert did assess the reasonableness of Fannie Mae’s bidding process for subcontractors and made recommendations that resulted in \$6.5 million in savings. Our analysis found that the entire amount of the savings was realized through price negotiations or other efficiencies discovered “behind the walls,” and no savings were realized or sought by reducing the quality or quantity of high-end features and finishes in the build-out.

costs, and whether such upgrades were cost-effective or appropriate for an entity in a federal conservatorship with an uncertain future to install in leased commercial space. In our view, that standard was consistent with FHFA's statutory duties, as conservator, to "preserve and conserve the assets and property" of Fannie Mae's assets, pursuant to 12 U.S.C.

§ 4617(b)(2)(B)(iv). In its response to that management alert, FHFA appeared to endorse our finding that it was required to assess the anticipated efficiencies of specific upgrades against the estimated costs of those features and determine whether the proposed upgrades for leased space in a building that is not owned by Fannie Mae or the U.S. government were appropriate for an entity in conservatorship. However, FHFA ultimately settled upon a different approach in which it assessed the reasonableness of the larger, more significant upgrades specified by Fannie Mae against the fitted-out space of major financial institutions and large public sector agencies and did not assess the reasonableness of individual, smaller upgrades.

In its management response to this status update, FHFA asserts that this update "serves no purpose other than to attempt to substitute [FHFA-OIG's] judgment" for judgments made by FHFA, as conservator, with respect to its oversight of Fannie Mae's upgrades to its Class A leased space. We respectfully disagree. While we do not question that Fannie Mae may compete against major financial institutions for its talent pool or that light-filled cooperative spaces with upgrades "above and beyond" Class A office space could promote employee recruitment and retention, Fannie Mae is unlike major financial institutions in one critical respect. Fannie Mae was placed into conservatorship in September 2008 and continues to operate in conservatorship and, by statute, FHFA is required to "preserve and conserve" Fannie Mae's assets and property. FHFA's expert and Committee members acknowledge that they did not consider whether the efficiencies of the upgrades specified by Fannie Mae justified their estimated costs, and whether such upgrades were cost-effective or appropriate for an entity in a federal conservatorship with an uncertain future to install in leased commercial space. As we explain in this status report, the benchmarking standard proposed by FHFA's expert, endorsed by its Committee, and approved by FHFA, is not consistent with FHFA's statutory obligation to "preserve and conserve" its assets and property.

The Inspector General Act of 1978, as amended, authorizes federal inspectors general to question costs. The Act defines a questioned cost to include, among other things, an expenditure of funds for the intended purpose that is unnecessary or unreasonable. Fannie Mae has leased space in a brand-new Class A building in downtown Washington, D.C., and FHFA's expert has determined that the industry baseline to build out that Class A space would be approximately \$175 per RSF. Unlike major financial institutions or large government agencies, Fannie Mae has been in conservatorship since 2008 and has an uncertain future and FHFA, as conservator, has an affirmative duty to "preserve and conserve" Fannie Mae's assets and property. While Fannie Mae may perceive that all of its specified upgrades "above and beyond" \$175 per RSF could promote employee recruitment and retention, FHFA has not determined that expenditure of Fannie Mae's assets for those

upgrades is necessary. Consequently, we question the basis for all upgrades, finishes, and “architectural” design elements that drive build-out costs for Fannie Mae’s leased space in Midtown Center above \$175 per RSF with a cost of at least \$32 million.<sup>15</sup>

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<sup>15</sup> Because FHFA’s expert’s report did not contain a specific discussion of the \$9.6 million or the architectural design elements reflected in the General Contractor’s 100% budget, it is unclear whether those amounts were included in the \$175 per RSF, the expert’s projection that Fannie Mae’s upgrades “over and above typical Class A space” amounted to \$32 million, or in addition to those costs.

## APPENDIX: FHFA MANAGEMENT RESPONSE.....



# Federal Housing Finance Agency

## MEMORANDUM

TO: Laura S. Wertheimer, Inspector General

FROM: Melvin L. Watt, Director *ED for MLW*

SUBJECT: Response to *Special Report: Update on FHFA's Oversight of Fannie Mae's Build-Out of its Newly Leased Class A Office Space in Midtown Center*

DATE: September 27, 2017

While I took serious issue with some of the factual assertions in the OIG's Management Alert of June 16, 2016 about FHFA's oversight of Fannie Mae's Washington, D.C. headquarters consolidation and relocation project,<sup>1</sup> that Management Alert contained two recommendations, both of which we acknowledged were constructive and we have fully implemented the action plans to which we agreed in our Management Response. Unfortunately, I believe that this Update to the June 16, 2016 Management Alert is seriously flawed and serves no purpose other than to attempt to substitute its judgments for legal judgments and decisions made and approved in good faith by FHFA as conservator. I fundamentally disagree with the interpretation in this Update of FHFA's statutory responsibilities as conservator, and I especially disagree with your view of the standards I am required to apply in fulfilling my obligations to "preserve and conserve" conservatorship assets. Under the Housing and Economic Recovery Act of 2008, my responsibilities as conservator include both the obligation "to carry on the business of the [Enterprises]" and the obligation to "preserve and conserve the assets and property of the [Enterprises]." FHFA is required to balance these statutory responsibilities throughout

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<sup>1</sup> Management Alert: Need for Increased Oversight by FHFA, as Conservator of Fannie Mae, of the Projected Costs Associated with Fannie Mae's Headquarters Consolidation and Relocation Project, June 16, 2016.

our work as conservator of Fannie Mae and Freddie Mac and there is substantial legal authority supporting FHFA's right to use its own judgment to make decisions about that balance.

The decision to allow Fannie Mae to consolidate into a single headquarters building in downtown D.C. was fully consistent with our conservatorship obligations. First, it will result in a more effective and efficient organization that will benefit the taxpayers in the following ways, among others:

- It will significantly reduce the costs of operating Fannie Mae relative to its current multi-building D.C. footprint by hundreds of millions of dollars;
- It will decrease the square footage of Fannie Mae's headquarters and result in more efficient use of space;
- It will allow management to implement a new way of working with significantly fewer individual offices and more common, shared space that enables Fannie Mae employees to work in a more collaborative and efficient environment; and
- In light of the uncertain future of Fannie Mae under housing finance reform and the uncertain timing of reform, it will allow Fannie Mae to conduct its business efficiently and effectively while it operates in conservatorship and will maximize the opportunity to sublease the space to a new tenant in the future if that becomes necessary.

The new D.C. headquarters consolidation meets FHFA's objective that this Enterprise continue to provide value to the U.S. housing finance market through its secondary mortgage market activities while it continues to operate in conservatorship. The consolidated headquarters will allow Fannie Mae to compete for and retain highly skilled employees in the financial services industry and to effectively serve its customers, including through capital markets transactions. Successful management of these business functions are essential to the successful operations of the company while in conservatorship.

Based on your recommendations, last summer we established a working group of FHFA staff with workspace and project management experience and hired an experienced engineering consulting firm to provide additional construction management expertise,

including a benchmarking exercise and regular review process to ensure the project was implemented in a cost-effective manner. We completed this exercise and shared the report with you. This increased oversight reflects an appropriate balancing of our obligations and conservatorship objectives.

I consider the build-out features reasonable, cost-effective and consistent with my responsibilities under the law and I, therefore, did not object to them. Some of these relate to the effective and efficient operation of Fannie Mae's market room, which provides critical capital markets financial services to help support and sustain the U.S. housing market. Fannie Mae's market room is a foundational component of that business function and is a necessary upgrade relative to the \$175/SF benchmark for generic Class A office space construction identified by our expert consultants. Some of the features, such as generators and mechanical and electrical infrastructure, support the market room by providing critical resiliency operations to ensure that the market room is functional at all times. The markets cannot be allowed to go down, even in the most adverse of circumstances.

FHFA and our expert evaluated the appropriateness and cost-effectiveness of the major upgrades. On the smaller upgrades, including the millwork subcontractor's \$9.6 million scope of work, FHFA appropriately delegated to Fannie Mae to make decisions on these items, which were included in the total build-out – \$221/SF – and lease costs that FHFA and its expert determined were reasonable and appropriate. This build-out estimate has now been reduced to \$219/SF and we expect the actual cost to come down further as the project reaches conclusion and unused contingency funds are released. We continue to make these decisions in good faith and with what we deem to be appropriate oversight consistent with the commitments made in response to your prior Management Alert and our statutory obligations.

cc: John Major, Internal Controls and Audit Follow-up Manager  
Larry Stauffer, Acting Chief Operating Officer

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