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RELEASED

The Honorable Lucien N. Nedzi
Chairman, Subcommittee on Military
Installations and Facilities
Committee on Armed Services
House of Representatives

NOVEMBER 7, 1979

HSE 22503
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Dear Mr. Chairman:

Subject: Standard Level User Charges Assessed to the
Department of Defense by the General Services
Administration (LCD-80-18)

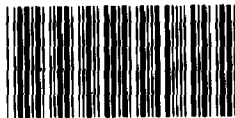
This report is in response to your June 6, 1979, request
concerning standard level user charges assessed to the Depart-
ment of Defense by the General Services Administration. You
asked us to determine whether the objectives of Public Law
92-313 are being met and complied with and whether the Depart-
ment is receiving equitable treatment. Our review was pri-
marily concerned with (1) the computation of annual rental
charges assessed the Department and (2) the reasonableness
of those charges.

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As stated in our July 5, 1979, letter, we did not
address those areas dealing with services paid for by the
Department (reimbursables), overtime services, and level of
cleaning service provided by General Services to the Depart-
ment, since they are the subject of ongoing reviews. We will
send you copies of the reports on these reviews when they are
completed.

Public Law 92-313, dated June 16, 1972, authorizes and
directs General Services to charge agencies for the space
they occupy and services rendered. The law states that the
charges (rental payments) "shall approximate commercial charges
for comparable space and services." The law, however, does
not contain any criteria or guidance for computing comparable
commercial rates.

The rents to be collected from all tenant agencies in
fiscal year 1980 are estimated at \$1.5 billion for about 277
million square feet of space, including parking, of which
about \$200 million will be collected from the Department for
about 40 million square feet of space. These collections



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will be deposited in the Federal Buildings Fund and then made available for building operations, including acquisition, construction, alterations, and repairs.

PROCEDURE FOR COMPUTING RENTAL RATES

To determine the approximate commercial rates for individual buildings for fiscal years 1975, 1976, and 1977, General Services used market surveys and quality rating factors to compute composite area rental rates. Rates were separately determined for various classes of space (office, storage, parking, etc.). In a prior report (LCD-75-325, Mar. 10, 1975), we noted that this composite average method, based on market surveys, was deficient because it did not give adequate consideration to the location of a building in determining rental rates on the commercial market. User agencies criticized the method because it was based on averages. To provide a more equitable and objective method of charging agencies rent for space, we recommended that a building-by-building approach be used, thereby, giving more consideration to the location of the buildings.

Beginning with the rental rates to be effective in fiscal year 1978, General Services adopted an appraisal method to arrive at the comparable commercial rate. Each Government owned and leased building was independently appraised. Appraisers estimated the building rates based on rental rates and details of three parcels of comparable commercial space which, in the opinion of the appraisers, was comparable to the Federal space examined.

Because appraisals are made before the start of the fiscal year to which they apply, General Services adjusts the appraised rates to account for inflation to the start of the fiscal year. For example, appraisals to establish the rental rates for fiscal year 1978 were made between December 1975 and May 1976. To update the appraisals to October 1, 1977, the start of the fiscal year, a 9.3-percent inflation factor was added. An additional charge for guard and security services was also added to the General Services' rental rates. Adjustments to appraisals for fiscal years 1978 through 1981 are shown in the following table.

<u>Appraisal adjustments</u>	<u>Fiscal years</u>			
	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
Inflation factor	9.3%	12.6%	12.9%	14.3%
Protection charge per square foot:				
Office, general storage and special space	\$0.28	\$0.28	\$0.30	\$0.31
Warehouse	\$0.09	\$0.07	\$0.08	\$0.09

For fiscal year 1979, one-third of the buildings were reappraised and a new rental rate was established for 3 years through 1981. For fiscal year 1980, another one-third of the buildings were reappraised and rental rates were established through 1982. For fiscal year 1981, the remaining one-third of the buildings will be appraised and rental rates will be established through 1983. This method will provide a new appraisal for a third of the buildings for computing rental rates every year. The rental rates are used for 3 years and the rates charged to tenant agencies do not increase during the period regardless of the effect of inflation on building operating costs.

While we recognize that appraisals are estimates of value based in part on judgments and opinions of independent appraisers, they do provide a basis for establishing comparable commercial rates as required by the law.

The rental rates for 57 office-type buildings occupied by the Department in the National Capital area were computed in accordance with the procedures described in this letter. Rental rates charged to other agencies are also computed in accordance with these procedures.

PROBLEMS WITH STANDARD LEVEL USER CHARGES

The Department of Defense has expressed concern about certain aspects of the standard level user charges program. Our comments on these concerns follow.

Rental rates for leased buildings

According to the Department, the rental rate it pays for space occupied in leased buildings is much more than the rates (1) General Services pays under its lease contracts or (2) the Department could obtain on the open market.

On an overall basis, the charges assessed to tenant agencies is more than the rent paid by General Services to lessors, including operating costs. For some buildings, however, the income collected is less than General Services pays for rent and operating costs. In a review of five leased buildings, we noted two cases where the rent collected from the Department did not equal the total paid by General Services for rent to the lessor and for services and utilities not included in rent payments.

On long-term leases, generally, the charges to agencies exceed the rent payments to lessors. This is because the charges to the agencies are adjusted every 3 years, while the rent payments to lessors on most long-term leases entered into before fiscal year 1974 are fixed and the leases do not include escalation clauses. Lease payments are no longer fixed on long-term leases entered into after fiscal year 1974. These leases contain escalation clauses requiring periodic rent adjustments.

The Department of Defense occupies some space in buildings constructed under the General Services' purchase contract program. This program permitted General Services to borrow funds needed for construction and to repay the amount borrowed over a 30-year period. Charges collected from agencies occupying space in the purchase-contract buildings are not sufficient to cover operating costs and payments for principal, interest, and taxes. We estimate that there will be a negative cash flow (income less than cash outlays) on these buildings for about 20 or more years.

Since the law directs General Services to charge agencies comparable commercial rates, General Services does not have a basis to charge agencies a rate based on cost. If rates were based on costs, there would be sizable variations in charges to agencies depending upon whether a building was Government owned or leased or financed through purchase contracting.

Increase in rental rates

The Department of Defense estimated that rental rates increased by 34.8 percent from fiscal years 1979 to 1981, a 2-year period, for office space in the National Capital area.

The highest increase in rental rates for office space occupied by the Department occurred in the National Capital area. General Services records indicate that the rental rate

for space occupied by the Department in General Services region 3, which includes the National Capital area, has increased by 28.3 percent. Nationwide, the increase in rental rates for the Department was 18.7 percent. In one region (New York) the increase was only 2.8 percent. The increases cited by the Department and General Services are for a 3-year period because, as previously discussed, rates are fixed for 3 years.

Because of the increasing demand for office space in the Washington, D.C., area, there have been sizable increases in commercial office rental rates. These commercial rates determine the size of the increase in rates paid by agencies since the rates charged are based on appraisals of comparable commercial buildings.

Resolving complaints about
standard level user charges

The Department has expressed a concern that the complaints on the unreasonableness of the rental rates are ignored by General Services on the rationale that only General Services has the authority to establish these rates.

The Department may review the appraisals which are used as a basis for establishing rents for Government owned and leased buildings. This information is in the General Services region in which the buildings are located. General Services, however, is reluctant to give agencies copies of appraisals.

Department officials advised us that they had met informally with General Services officials to discuss the fiscal year 1981 rental rates. According to the General Services records, the Department did not formally appeal the rental rates.

The Federal Property Management Regulations provide agencies an opportunity to request General Services to review its rental rates without resorting to a formal appeal. An agency may submit a formal appeal only when the rental rates exceed the comparable commercial square foot rates by 25 percent or 50 cents a square foot, whichever is greater, or when the quarterly standard level user charge exceeds the comparable commercial charge for that quantity of space by more than \$12,500.

If necessary, an agency may file up to three appeals. The first appeal is filed with the appropriate General Services regional office. A second appeal is filed with the General Services Commissioner of Public Buildings Services. A third appeal, if necessary, is filed with the Administrator of General Services. The Administrator's decisions are final.

Landlord-tenant relationships

According to Department officials, improved landlord-tenant relationships between General Services and the agencies were to be one of the benefits of the standard level user charge program. Department officials believe these relationships have never been achieved. They advised us that they are experiencing deteriorating services from the building owners of the space which the Department leases and from contractors who provide services, such as janitorial services, in Government-owned buildings.

Department officials also believe that General Services should enforce the performance of the services that lessors and contractors have agreed to provide. Additionally, General Services should be held accountable for ensuring that the services are performed. The officials also believe that the Department could get better service by dealing directly with the lessors and contractors. As previously stated, we will address the area concerning the level of services provided the Department in one of our other reviews.

Higher rates for special purpose space

The Department of Defense is concerned that it frequently has to pay for space alterations that General Services is not in a position to pay for them. After the space has been altered and upgraded, General Services will reclassify it and then charge the Department a higher rental rate.

Both General Services and the tenant agencies fund space alterations in Government owned or lease buildings. When space is upgraded, General Services will charge the tenant agency a higher rental rate. For example, if office space in a building is converted to a computer facility, General Services would increase the office rate by 25 percent. If office space is upgraded and converted to computer space at General Services' expense, it would appear that a rate increase is justified if the comparable value of the space is increased. In some situations, however, tenant agencies,

including the Department, pay for space alterations involving computer installations or other conversions because General Services does not have sufficient funds available. When the tenant agency pays for the conversion and then pays a higher rental rate, it, in effect, is paying twice for the alteration work.

Other examples of office space converted to special purpose space and the applicable percentage rate increase follow.

<u>Type of space</u>	<u>Percent increase</u>
Laboratory and clinic	75
Food service	64
Structurally changed	40
Conference and training rooms	13

If office space is converted to light industrial or general storage use, the rental rate is reduced by 25 and 30 percent, respectively.

We believe that tenant agencies have a basis for questioning the reasonableness of General Services rental rates when agencies pay for improvements and then are assessed a higher rate because of the improvements. The increased rate appears to be based on cost, which is not the basis for the user charges. If agency-financed alterations result in an increase in the commercial value of the space and a corresponding increase in the rent, we believe the agency should receive a credit for financing the alterations as a reduction against the user charge payments. Of course, for General Services-financed alterations, an increase in commercial value would justify an increase in user charges, as provided by Public Law 92-313. As stated in our March 1975 report, General Services should identify building improvements which have been financed with agency funds and reduce the indicated rental rates accordingly, but General Services did not reduce the rates.

RECOMMENDATION

We recommend that the Administrator of General Services discontinue the practice of assessing higher rental rates on building improvements unless justified by increased commercial value increases and after providing adjustments for alterations financed by tenant agencies.

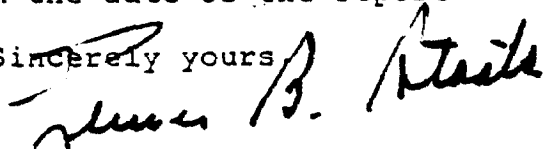
AGENCY COMMENTS

We discussed a draft of this report with officials of the Department of Defense and the General Services Administration. These officials did not object to the findings contained in the report, but General Services officials did not agree with the recommendation to discontinue the practice of assessing higher rental rates on building improvements financed by tenant agencies. These officials contend that when tenant agencies properly plan and schedule projects in accordance with the standard budgetary process, General Services can and does finance the work within the Federal Buildings Fund. They also contend that when tenant agencies fail to plan properly and submit requests after completion of the budget process, General Services has no alternative but to perform the projects on a reimbursable basis since finances are already committed and planned.

In view of the limited funds available for capital expenditures in the Federal Buildings Fund, General Services has not been able to adequately support a program for building improvements and construction. As a result, General Services is not in a position to fund all improvements, such as computer facilities, required by tenant agencies even if there is adequate advance planning.

As arranged with your office, we are sending copies of this report to the Administrator of General Services and the Secretary of Defense. Unless you publicly announce its contents earlier, no further distribution of this report will be made until 10 days from the date of the report.

Sincerely yours



Comptroller General
of the United States