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WASHINGTON, D.C 20548

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STATEMENT OF

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LOGISTICS AND COMMUNICATIONS DIVISION

BEFORE THE

COMMITTEE ON ENVIRONMENT AND

PUBLIC WORKS

UNITED STATES SENATE

ON THE

[FEDERAL BUILDINGS FUND AND THE

USER CHARGES PAID INTO THE

FUND BY FEDERAL AGENCIES]

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STATEMENT FOR THE

COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS

U. S. SENATE

SEPTEMBER 18, 1979

Mr. Chairman, members of the Subcommittee, we are pleased to appear before you to discuss the Federal Buildings Fund and the Standard Level User Charges which provide the major source of revenue for the Fund.

The Federal Buildings Fund was established pursuant to Section 3 of the @06 Public Buildings Amendments of 1972 @07 (Public Law 92-313). The Act also authorizes GSA to charge agencies a standard level user charge for space occupied and services received. According to the law, the charge for space shall approximate commercial charges for comparable space and services. The user charge collections are deposited in the Federal Buildings Fund and are available to GSA for expenditures for real property management and related activities in amounts specified in annual appropriations acts.

In establishing the Federal Buildings Fund, GSA anticipated that there would be more efficient and economical use of space if agencies had to budget and pay for the space. It also believed that the fund would generate sufficient money for capital expenditures.

You requested us to provide information on 3 issues about the Fund, the first and second being the apparent failure of the Fund to pay for operations, maintenance, and repairs of Federal buildings and the failure of the Fund to finance the purchase or construction of new buildings. The third issue is whether the level of services provided by GSA to its tenant agencies is commensurate with the user charges that are levied.

INABILITY OF THE FUND TO MEET BOTH OPERATING AND CAPITAL REQUIREMENTS

When GSA officials testified on the 1972 legislation authorizing establishment of the Federal Buildings Fund, they estimated that about $200 million of its income would be available every year for new construction Having such a financing source for construction projects was one of the principal objectives of the Congress in approving the Fund. That objective, however, was not attained The Fund's income and expenditures left an average of only about $50 million a year available for construction of Federal buildings since the Fund's inception in 1975. For fiscal year 1980 GSA estimates that it will obligate about $86 million for construction, and is requesting only $16 3 million of new obligation authority.

Another capital requirement of the Fund is the backlog of alterations and major repair work in Federal buildings. That amounts to an estimated $1 1 billion currently. The backlog has increased since the Fund was established Part of the reason was inadequate funding during fiscal years

capital req.
operating req

1975 through 1977, when only about $100 million a year was obligated for this work. In fiscal years 1978 and 1979 GSA budgeted about $200 million a year for alterations and major repairs, and obligated most of a special $50 million supplemental appropriation that became available in late 1977. When Congress was considering the increase of obligation authority to $200 million a year, GSA officials stated that the additional funds would bring the backlog down to a manageable level of about $500 million of work in 5 years After nearly 2 years of higher expenditures, however, the backlog has actually increased slightly.

While there has been relatively little spent for construction and major repairs, the expenditures for leased space has increased dramatically from 1975 to 1979 - from about $364 million to an estimated $520 million The amount of square feet leased has increased from 80 to over 93 million square feet. For fiscal year 1980, GSA is requesting new obligation authority of $555 million to rent space. Just the increase in annual rental payments from 1975 to 1980, about $190 million, is over 3 times the average annual expenditures for construction and nearly as much as the current level of alteration and major repair expenditures

cash drain

Another growing cash drain on the Fund is the payment of principal, interest, and real estate taxes for buildings constructed under the purchase contract authority of the 1972 law. As you know, GSA borrowed about $1.3 billion under

cash d

several financing arrangements to construct 68 Federal buildings. In fiscal year 1975, the Fund paid about $16 million of financing charges and taxes. For fiscal year 1980, GSA estimates that the Fund will have to pay about $100 million of principal, interest, and taxes on those projects. According to GSA estimates, the annual payment will increase to a high of $175 million a year This assumes that taxes will increase at an annual rate of 3 percent

The remaining financial needs of the Fund are to pay for buildings operations and maintenance, protective services, general administration, management, and certain services peculiar to GSA's central property management responsibilities. The estimated obligations for these functions increased from about $414 million in 1975 to a forecasted $571 million for fiscal year 1980.

The following table summarizes GSA's estimate of obligations to be incurred in 1980 for the Fund's major programs, and the percent of the total increase in estimated obligations between 1975 and 1980 attributable to each of the major programs. The total for all programs increased from about $952 million to an estimated $1,511 million for 1980, according to GSA's budget submissions for those years.

Program	Estimated 1980 Obligations (millions)	Percent of 1980 Total	Percent of Total Increase Since 1975
Construction	$ 86,187	5 7%	3.9%
Alterations	200,000	13 3	19.1
Purchase Contract Pay'ts	99,700	6.6	14.9
Rental of Space	554,600	36.6	34.1
Real Property Operations	498,063	33.0	25 4
Program Direction	72,472	4.8	2.6
Totals	$1,511,022	100.0%	100.0%

Insufficient Data for Detailed Analyses

There are both legislative and administrative reasons for the shortage of the Fund's income to meet operating expenses and provide financing for new construction. Before describing these reasons, one must qualify any analysis of the Fund's income and expenses by noting that GSA's financial reporting system is woefully weak on the details of its public buildings operations. Complete costs and income, and certain capital improvements, are not reported by individual buildings. Thus, one cannot assemble and analyze the financial results by responsibility centers or the major classes of buildings (lease vs owned, office and similar structures vs others, newer buildings vs older buildings, and the like)

We reported these deficiencies to the former Administrator of General Services with recommendations for improvements in November 1978. GSA accepted our recommendations and expects to complete part of the required system improvements at the beginning of fiscal year 1980 and the remainder one year later. In the meantime, our analyses of the Fund's financial problems are necessarily limited to overall generalizations based on tests of data for small samples of buildings and some very broad estimates.

Limitation on Income
Permitted to Be Collected

In fiscal year 1975, the Office of Management and Budget (OMB) reduced GSA's space rental rates by 13 percent. According to OMB, the purpose was to make allowance for commercially equivalent rates that would be lower than determined by GSA for tenants that occupy space for longer than one year.

For the same year and again for fiscal year 1976, the appropriations committees reduced agency rental payments to GSA by 10 percent. From the record of committee hearings and other sources, it is apparent that there were 2 principal reasons for the action. One was a general feeling that GSA's space charges were too high; the other was the still considerable opposition to the principle of the revolving fund, whereby agencies paid GSA for the space they occupied.

For fiscal year 1977, GSA agreed with members of Congress to internally reduce its rental rates by 10 percent, so that a congressionally imposed reduction would be unnecessary.

For both fiscal years 1976 and 1977, OMB required GSA to develop a discounted rate for agencies which occupied the same space for an extended period.

I will describe GSA's method of setting its rental rates later. The point to be made here is that these restrictions on how much it could charge agencies reduced the Fund's income substantially during fiscal years 1975 through 1977. For the latter 2 years GSA estimates the loss of income to have been over $400 million a year. It was unable to estimate the loss for 1975.

We believe it to be a fair assumption that the original rates set by GSA for the 3 years through 1977 were too high, in relation to comparable commercial rental rates as required by the authorizing legislation Based on our comparison with the rental income collected in 1978, when there were no restrictions and a new method for setting the rates, we believe that a reasonable estimate of the lost revenue in relation to a fair rental rate is about $200 million a year. Thus, for the 3 years through 1977 the total reduction of income was probably about $600 million.

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Cost of Federal Buildings Not Recoverable by Commercial Rents

Federal buildings cost much more to construct tnan do similar commercial buildings used for determining the rental rates GSA charges its tenant agencies

The most definitive study of these differences, insofar as we are aware, is the Hanscomb study completed in 1976. Hanscomb Associates is a consulting firm hired by GSA to make a comparative cost study of Federal and private office building construction, and to explain the causes of the cost differences. Hanscomb made a preliminary analysis of 26 private buildings and 38 Federal buildings managed by GSA From these the firm selected 6 private and 5 Federal buildings for detailed analyses of the differences in construction costs

Hanscomb reported the following differences in the average costs per gross square foot to construct these buildings·

Private - for general rent	$25.53
Private - owner occupied	34.22
Federal buildings	46.30

Inasmuch as GSA's charges to tenant agencies are based on commercial buildings available for general rental, the pertinent cost comparison above is the difference between $25 53 and $46.30. Thus, the Federal building cost in this small sample is higher by $20.77 per square foot, or about 80 percent. Hanscomb attributes the differences to the following factors:

a) scope - Federal buildings simply have more in them than their private counterparts (eg , interior tenant work, special facilities such as courtrooms, special features such as extra standby power, etc.);

b) quantitative - the Federal projects require more quantities of material and components to enclose the same given floor area, i e., their plan forms and geometric layouts are more complicated than the private counterparts;

c) qualitative - the Federal buildings demand higher performance and specify better quality;

d) unidentified causes - that cannot be attributed to any one of the factors above, or which may arise due to intangible factors (Includes labor standards, safety factors, Buy-American, more restrictive Federal specifications, more cumbersome Federal procurement requirements, and other intangibles.)

Hanscomb estimates that the greater scope of Federal buildings accounted for nearly 40 percent of the cost differential, qualitative factors for about 30 percent, the quantitative for 21 percent, and the unidentified for less than 10 percent.

While the Hanscomb report is admittedly based on a very small sample, it does give some insight into why Federal buildings are more costly. In layman's terms, they have higher ceilings and relatively more area for lavatories, elevators, lobby and hallways, mechancial and service areas While the quality of such buildings probably gives them a longer useful life, it is doubtful that even on a life cycle cost basis they would recover full costs as a rental venture for profit.

Another demonstration of the point is the cash flow situation of those Federal buildings recently constructed under purchase contract borrowing authority (Public Buildings Amendments of 1972). Under that authority GSA borrowed about $1 3 billion to construct 68 buildings having about 13.5 million square feet of net usable space. We were able to collect all the fiscal year 1978 expenses and other payments for 21 of these buildings. The selected buildings were at least 95 percent occupied in 1978, which would appear to represent a fairly normal year of operation.

On these purchase contract buildings, the Fund has to pay over a 30 year period the redemption of principal borrowed, interest on the borrowings, and real estate taxes because title to the buildings are held by a private trustee. In addition, of course, the Fund has to pay for regular buildings operations and maintenance and for periodic alterations and major repairs.

For the 21 buildings, GSA's rental income was about $32 million and its total cash outlays were about $49 million. The costs of operations and maintenance and alterations and major repairs, including our estimate of administrative overhead, amounted to about 45 percent of the rental income. Principal, interest, and taxes collectively were about 105 percent of the income. Thus, the total cash outlays exceed rental income by about 50 percent.

If the same cash deficit per square foot is applicable to the other purchase contract buildings, when all 68 are in full operation the outlays will exceed total income in constant 1978 dollars by between $40 million and $50 million a year That is a substantial drain on the Federal Buildings Fund, which will persist for 30 years barring the effects of inflation. Any degree of inflation will increase the rental income relatively more than outlays, because the principal and interest payments are fixed annual amounts. After 30 years, of course, the Government will have buildings useful for some more years completely free of taxes and financing costs.

GAO is currently making a study of purchase contract financing for the House Subcommittee on Public Buildings and

Grounds Because the study is not completed and reported to that subcommittee, we are not able at this time to provide any additional information.

(3) Costs of Space Management Services Peculiar To GSA's Responsibilities

The Fund's rental ~~income~~ also has to pay for services that commercial landlords do not provide. No allowance is made for these costs in the establishment of comparable commercial rental rates charged GSA's tenant agencies.

GSA provides more assistance to Federal agencies in planning space layouts and making moves. GSA pays a large part of the costs of moving agencies within and between buildings. GSA also inspects the agencies' use of Federal real property, including that under management of other agencies, and assists agencies in making internal property surveys. The latter function's are a GSA responsibility to see that Federal facilities are used efficiently and that unneeded facilities are released for other Federal use or disposal

We were unable to obtain an estimate of the costs of these special services in the time available, but can make a rough guess from certain organizational and functional data. We hazard a guess that the total amounts to $10 million or $12 million a year

(4) Age of Federal Buildings Requires Substantial Renovation Outlays

When the Federal Buildings Fund was established in 1975, it received about $3 5 billion worth of Federal buildings as contributed capital - no cost to the fund. The value recorded was the original cost of the land and improvements. The appraised value of those properties, if made, would undoubtedly have been much higher.

These buildings, particularly those of more recent vintage, are the principal source of a positive cash flow for the Fund. That is, those buildings in which substantial renovations were not yet made returned most of the excess of income over expenses to finance construction, alterations and major repairs in other buildings, and deficits on the purchase contract buildings.

Not all of these original buildings are a paying proposition, however. About one-half the total square footage of GSA owned structures are in buildings over 30 years old. About 70 percent of the alterations and major repairs backlog of over $1.1 billion is required for those older buildings.

We estimate that the average alteration and repair requirement for office buildings over 30 years old is about $15 per square foot. For those over 40 years old the requirements are an average of nearly $25 per square.

In our opinion, an average expenditure of $200 million a year is not adequate for the total requirements of such work. If it is not increased, essential work will continue to be deferred and buildings will deteriorate, including some vacant space that could be brought into use. If the annual expenditures are increased, there will be more Federal buildings in a negative cash flow position for some years, until the cumulative income covers the extraordinary renovation costs plus ordinary operations and maintenance.

THE STANDARD LEVEL USER CHARGE FOR GSA MANAGED SPACE

fair + equal treatment to all agencies

Public Law 92-313 (40 U.S.C. 490) authorizes the GSA to charge agencies for the GSA controlled space they occupy. These rental payments are officially called Standard Level User Charges. The law states (Section 4) that the charges to the agencies ". . . shall approximate commercial charges for comparable space and services . ' The law does not contain any criteria or guidance for computing comparable commercial rates.

Throughout the legislative process leading to the enactment of Public Law 92-313, GSA officials testified in support of a charge to agencies for space, which they believed would create savings by making the agencies accountable for the cost of space they occupied and enable GSA to improve service to customer agencies by providing greater flexibility in funding public buildings activities.

Starting in 1975, GSA determined comparable commercial rates for individual buildings by using market surveys and quality rating factors to compute a composite area rental rate Rates were separately determined for each of seven classifications of space (office, storage, special, parking, etc), based on 500 sample locations for lease on the commercial market in the cities which contained 75 percent of all GSA-owned and controlled space

For fiscal year 1976, GSA's space rental rates were developed in the same way as fiscal year 1975 except the sample size was increased to 4,800 locations and the space classification was enlarged to 12 classifications. For fiscal year 1977, GSA retained the fiscal year 1976 rates GSA also granted a length-of-occupancy discount in 1976 and 1977 to comply with OMB's directive, as previously described The discount system had the effect of reducing GSA's rental income by approximately 20 percent nationwide.

GSA's internal audit group issued a report critical of GSA's method for calculating space rental rates for fiscal year 1976. The Internal Audit report stated that use of the market survey did not adequately account for the significance of location in determining commercially comparable rental rates. GSA's report confirmed the findings in a GAO report issued in 1975.

In use at the present time is a method GSA adopted to determine space rental rates starting in fiscal year 1978 For fiscal year 1978, each Government owned and Government leased building was independently appraised and a fair annual rental rate comparable to commercial rent was established This rate was used in fiscal year 1978 for all buildings.

For fiscal year 1979, 1/3 of the buildings were reappraised and a new rental rate was established for such buildings through 1981. Another 1/3 of the buildings were reappraised for fiscal year 1980 and rental rates established through 1982. For fiscal year 1981 the remaining 1/3 will be appraised and rental rates established for these buildings through 1983 This method will provide a new appraisal for a third of the buildings for computing rental rates every year

Based on GSA's leasing experience, the agency determined that a typical GSA lease is for a term of 3 years for 3,000 to 5,000 square feet of space. These characteristics plus full service for utilities, sanitation and maintenance were considered the common denominator for appraisals under the new method.

To support their estimated rates for GSA space, the appraisers record descriptive details on 3 parcels of commercial space which, in their professional judgment, are comparable to the Federal space being examined. For appraising space in rural areas or small towns, appraisers may seek comparable commercial space as ~~for~~ far as 50 miles away, if none is closer, but may not use buildings in metropolitan areas.

The rates derived from these appraisals are in effect for 3 years. Because appraisals are made about 18 months before the period to which the rates apply, GSA adjusts the appraised rates to account for estimated inflation. For example, rental appraisals for fiscal year 1978 were conducted between December 1975 and May 1976. To update the appraisal, a 9.3 percent inflation factor was added to cover the period from May 1976 to October 1, 1977. A 12.6 percent inflation factor was added to update the appraised rates for those buildings appraised between October 1976 and January 1977 to prepare space rental rates for fiscal year 1979 thru fiscal year 1981.

In 1978 we reported on a review of Agriculture's space rental payments to GSA and concluded that the fair annual rental method appears to provide defensible, documented, commercially comparable rental rates and that all Federal agencies receive fair and equal treatment from GSA.

The Congress and OMB did not reduce GSA's planned user charges for fiscal year 1978, but the 1978 appropriation act required GSA to deposit, in miscellaneous receipts of the Treasury, any income in excess of the amount specified in the act for its building operation. Through fiscal year 1977, GSA had transferred about $7 million from the fund to miscellaneous receipts of the Treasury.

3-Year Fixed Rental Period Not Compensating For Inflation

As described, GSA has one-third of its buildings appraised every year, to establish a comparable commercial rental rate that remains fixed for 3 years. The appraiser's estimate is adjusted for anticipated inflation to the beginning of the first fiscal year of the period. No further increase is made in the charges to tenant agencies during the period, regardless of the effect of inflation on GSA's costs to operate the buildings.

On the other hand, GSA adopted a policy in 1978 of including an annual escalation clause for operating costs and taxes in all new leases for rented space. Operating costs, as defined in the leases, is adjusted up or down each year by the change in the Consumer Price Index since the prior year. Taxes are generally adjusted for the actual increase or decrease of payments from the prior year. We understand that all new multi-year leases entered into for approximately the past 18 months have this form of escalation clause.

GAO reported on escalation clauses to the House Subcommittee on Public Buildings and Grounds in November 1978 (LCD-78-340). We disagreed with the policy of annual escalation clauses related to the Consumer Price Index, and recommended to the former Administrator that the policy be cancelled. In our opinion, annual escalation is too frequent considering the administrative work involved, the landlord is completely relieved of any financial risk, and there are other alternatives that ought to be considered. GSA did not change its policy.

We were unable to determine how many GSA leases include the annual escalation clause, and how much of the total annual rent is subject to it. From office building rental statistics published by the Building Owners and Managers Association, it would appear that on the average 35 percent to 40 percent of total rent payments would be subject to escalation as operating expenses and from 15 percent to 20 percent as real estate taxes. Thus, over one-half of rental payments under the new policy are subject to annual increases.

On most of its leases entered into between 1974 and 1978, GSA made some form of compensatory adjustment for the landlord's operating costs and taxes, regardless of the length of the lease. In one case, GSA negotiated a reduction in rent and and assumed the responsibility for providing the utilities and cleaning. On lease renewals, GSA included escalation clauses to compensate the landlords for increased operating costs and taxes, but these adjustments are usually made about every 3 years and are related to the actual increases in costs.

GSA is now experiencing a severe financial pinch from increased demands for space and rising rental rates for new space as well as from the annual escalation adjustments on its rental payments. GSA had to request a supplemental appropriation of $14 million for rental of space in fiscal year 1979. Some of that additional money is needed for increased agency space requests and some for increased rental payments. The $555 million requested by GSA for rental of space in fiscal year 1980 is now considered inadequate. GSA has prepared a supplemental appropriation request for fiscal year 1980 of about $16.1 million, which is now under study in OMB. Furthermore, GSA plans to turn over for Department of Defense management and payment certain GSA leases for recruiting stations

Costs are, of course, going up every year on tne Federally owned buildings, as well as on leased buildings. In this period of high inflation, therefore, a fixed rental charge to the agencies for a 3-year period is a severe, self-imposed financial restriction on the Fund.

This restriction can be removed administratively. A simple solution would be to estimate the effect of inflation on GSA's rental charges to agencies through the mid-point of each 3-year period. That would establish, as near as can be forecasted, an average comparable commercial rental rate for the period. The Committee may want to consider this and other alternatives in discussions with GSA officials

LEVEL OF SERVICES PROVIDED FOR
THE STANDARD LEVEL USER CHARGES

We do not know whether or not the services GSA provides its tenants ~~is~~ commensurate with a commercial equivalent rental charge. GSA's instructions to its contract appraisers call for determining the comparable commercial rent for approximately equivalent quality and location of space and full services. The services include utilities, cleaning, and full operation of the building by the landlord

GSA does provide fully serviced space to its tenant agencies, for a fixed period of weekly operations and at a certain level Tenants are charged separately for using a building beyond normal operating hours, for extraordinary use of electricity (such as a computer center), for a higher than standard level of cleaning or protective services, and for the alteration of space considered above normal office accommodations.

In 1978 GSA's tenants reimbursed the Fund about $110 million for "extra" buildings services, including $45 million for utilities. The agencies also reimbursed GSA nearly $50 million for additional protective services and over $40 million for special alterations.

We are currently reviewing the bases for determining that a building service is either included in the tenant's rent or is an extra charge. We have not advanced far enough to have any useful information at this time

OBSERVATIONS

Regarding the financial capacity of the Federal Buildings Fund to fully recover from its income the cost of constructing and operating Federal buildings, we believe the Committee should consider the following factors.

Construction Standards

The construction standards of GSA result in a better building, but a much more costly building, than the commercial buildings on which the Fund's income is based Commercially comparable rent will never fully pay for the costs of construction, interest, operations, and periodic renovation unless there is a steady and fairly high rate of inflation during a building's life.

Some alternatives to consider are (1) construct Federal buildings to the standards of commercial buildings; or (2) change the law to permit GSA to charge agencies a rent commensurate with the higher costs and quality of Federally constructed buildings; or (3) provide GSA with supplemental appropriations for construction of new buildings to make up the difference between commercial building costs and Federal costs, or (4) some combination of these.

Backlog of Alterations and Repairs

GSA's large backlog of alterations and major repairs may also require some additional capital not available from its rental income. First, though, GSA's Public Buildings Service should carefully review the requirements building by building, assure their reliability, and sort out those buildings that are economically repairable. The Committee may then want to consult with GSA officials about these needs and the capability of the Fund's income to meet them within a reasonable time If sufficient rental income is not available, the Committee may want to consider sponsoring a supplemental appropriation or a loan authority for GSA similar to that being considered for construction of new buildings.

In this connection, there are some historically valuable buildings in GSA's inventory that require substantial renovation. Some of these, it appears to us, are not economically repairable. In such cases, the Committee may want to consider the possibility of separate supplemental appropriations for the difference between full cost of renovation and that portion that is recoverable from rental income

Central Property Management

We mentioned above the services GSA renders as the Government's central manager of real property operations These are over and above a landlord's normal services to tenants, and are not covered by commercial rental rates. The Committee may want to consider having the Congress authorize payment for these services from a separate appropriation rather than from the rental income of the Fund

Financial Reporting and Analysis

We are unable to comment on the extent of possible inefficiencies and the impact on the Fund's 'profitability" because of inadequacies in its financial reporting. However, as we noted earlier, GSA has accepted our recommended corrective actions If fully implemented, these actions should enable GSA officials in fiscal year 1981 to (1) detect problem buildings and wasteful or possibly improper practices and (2) make more informed decisions on alternative ways of acquiring space and services and on the economic feasibility of major renovations to existing property.