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Briefing Report to the Chairman, Committee on Government Operations, House of Representatives

March 1990

LEASE REFINANCING

Progress in Reducing Army's Equipment Leasing Costs

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Washington, D.C. 20548

Accounting and Financial
Management Division

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March 13, 1990

The Honorable John Conyers, Jr.
Chairman, Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

On February 20, 1990, your office requested information on the progress of the Army's equipment lease refinancing program, which was initiated to reduce equipment leasing costs. We were also asked the status of our efforts to assess the potential of expanding this program throughout the Department of Defense (DOD). This report presents the results of our February 23, 1990, briefing to your Committee staff.

RESULTS IN BRIEF

DOD equipment leasing has declined between 1985 and 1988 at least in part because of an earlier DOD program to buy out uneconomical automated data equipment leases. The Army, which has over half of DOD's lease obligations, found that only a small portion of the lease obligations covered by its program may be viable candidates for pooling and refinancing. The Army is also pursuing individual lease renegotiations as an option to reduce leasing costs. Our analysis to determine whether lease refinancing should be considered as a cost-cutting method for other DOD components is not yet complete.

BACKGROUND

DOD leases a wide variety of real and personal property, including buildings, facilities, and equipment. Such leases include several cost components including the interest rate on the underlying financing. These interest rates are often higher than what could be obtained on the open market.

A comparison of fiscal year 1985 and 1988 equipment leasing activity shows a reduction in leases and leasing costs over that 4-year period. During 1985, DOD had 5,535 equipment leases valued at about $868 million. Since then, the number of leases has declined by 4,076, or about 74 percent. Table 1 provides more detailed information on equipment leases reported by the major DOD components during fiscal year 1988.

Table 1: Equipment Leases by DOD Component for Fiscal Year 1988

DOD component	Number of leases	Dollars obligated (thousands)	Percent of total obligations
Army	645	$257,990	50
Navy	384	122,605	24
Air Force	280	88,853	17
Army Corps of Engineers	103	26,956	5
Defense Logistics Agency	47	18,215	4
Total	1,459	$514,619	100

According to a report[1] by the Department of Defense Inspector General, DOD's buyout program for uneconomical automated data processing equipment leases significantly reduced equipment leasing costs. The report noted that budget requests for leasing such equipment declined $627 million, or 74 percent, between fiscal years 1984 and 1988.

OBJECTIVES, SCOPE, AND METHODOLOGY

Your office requested that we provide (1) information on the progress of the Army's program to refinance existing equipment leases and (2) the status of our efforts to determine whether this type of initiative could be expanded throughout DOD.

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[1]Summary Report on the Defense-wide Audit of Acquisition of Automatic Data Processing Equipment (Report No. 89-038, December 2, 1988).

To ascertain the status of the Army's current efforts to lower equipment leasing costs, we interviewed Army officials responsible for developing and implementing the master lease refinancing program. Because the Army contracted with Chase Manhattan Capital Markets Corp. and Bear, Stearns and Co., Inc., to implement the lease refinancing program, we discussed the results of their detailed analyses of individual leases and other related matters with key officials of those firms. We did not verify the results of their work.

We determined the extent of equipment leasing for each DOD component by extracting data from the Defense Contract Action Data System, which is to contain data on all DOD contracts. The most recent data at the time of our review covered fiscal year 1988. These data show the amount of equipment leasing for each DOD activity; however, we have not yet examined leasing policy or lease contract provisions for individual leases or the extent to which these leases may be eligible for refinancing.

ARMY LEASE REFINANCING PROGRAM

Army officials are continuing to seek opportunities to reduce equipment leasing costs. During 1988, the Army contracted with the investment firms mentioned above to determine the feasibility of pooling and refinancing existing equipment leases with third-party investors. This concept of third-party refinancing as envisioned by the Army is discussed in our report issued to you in November 1989.[2]

The Army's contractor reviewed 2,203 equipment leases and lease modifications recorded in the DOD-wide data base[3] and valued at over $315 million in annual lease obligations.

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[2]Lease Refinancing: Observations on GSA's Proposed Master Leasing and Army's Lease Programs (GAO/AFMD-90-7, November 24, 1989).

[3]The contractor evaluated Army leases from fiscal year 1988 and part of 1989. Leases may include numerous modifications. We did not attempt to determine whether the 2,203 leases and lease modifications included all of the 645 Army leases in table 1.

It determined that 2,039 of these contract actions ($275 million) were not eligible for refinancing for one or more of the reasons listed below:

-- The lease had expired or would expire within 6 months of the review date.

-- The lease contract was for maintenance, service, or a rate-controlled activity such as telephone service that did not involve the leasing of equipment.

-- The lease had already been bought out.

-- The lease was a straight rental lease and thus did not contain an assignable purchase option that would be necessary under the Army's lease refinance program.

The contractor's analyses indicated that the remaining 164 lease contract actions valued at $40 million, or 13 percent of the total, may be refinanceable. The contractor classified 51 of these, valued at $3.7 million, as priority leases for refinancing. This determination was made based on a number of factors, including the type of equipment involved and its location.

In addition, the contractor identified several large leases that were not recorded in the DOD-wide lease data base. The Army is currently attempting to renegotiate these leases. Army officials told us that they have already renegotiated one lease for telecommunication equipment, resulting in a $1.3 million annual savings.

LEASES AT OTHER DOD COMPONENTS

Our analysis regarding whether other military components could pool and refinance existing leases to reduce lease costs is in its initial stages. We have, however, determined that currently the Army is the only military activity with a major lease refinancing program. As shown in table 1, the Navy, the Air Force, and the Defense Logistics Agency reported having 711 equipment leases totaling almost $230 million during fiscal year 1988. These represent about 45 percent of DOD's equipment leases.

We are continuing our evaluation of the Army's program to reduce equipment leasing costs by refinancing existing leases through third-party investors. We will also assess the potential of expanding this program to the Navy and the Air Force.

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As agreed with your office, we did not obtain official agency comments on a draft of this report; however, we did discuss these matters with agency officials. Also, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Director of the Office of Management and Budget, the Secretary of Defense, the Secretary of the Army, and other interested parties. We will make copies available to others upon request.

Please contact me at 275-9454 if you or your staff have any questions concerning this briefing report. Other major contributors to this report are listed in appendix I.

Sincerely yours,

Jeffrey C. Steinhoff
Director, Financial Management
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