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REPORT BY THE

Comptroller General

OF THE UNITED STATES

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Costs And Budgetary Impact Of The General Services Administration's Purchase Contract Program

As a means of financing space acquisition, General Services purchase-contract program is more costly than direct Federal construction. However, the program offers certain benefits which can make purchase contracting a useful alternative to direct Federal construction and leasing.

General Services purchase-contract authority expired in 1975. Pending legislation either would restore that authority or authorize the agency to finance public-building acquisition or construction by direct Treasury loans.

If new legislation is enacted, General Services financing authority should be limited to direct loans from the Treasury or Federal Financing Bank. Further, if the agency's Federal Buildings Fund is required to pay local real estate taxes under the new legislation, the Fund should be compensated for such payments.

UNITED STATES GENERAL ACCOUNTING OFFICE

507537

LCD-80-7
OCTOBER 17, 1979

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-95136

The Honorable Elliot H. Levitas REA
Chairman, Subcommittee on Public
Buildings and Grounds
Committee on Public Works
and Transportation
House of Representatives HSE03104

The Honorable James D. Abnor REG
Ranking Minority Member

AGC00017

By letter of March 19, 1979, the Chairman and the Ranking Minority Member jointly requested that we compare purchase contracting with funding by appropriations (direct Federal construction) and leasing as a means for the General Services Administration to finance the acquisition of space for Federal departments and agencies. We were specifically asked to analyze and compare financial benefits and costs, budgetary impact, and secondary impact on local tax structure. We also were requested to examine options to and possible pitfalls of General Services 1972 purchase-contract program. ID The 3-year authority for this program expired in June 1975.

The House and Senate Committees on Appropriations and on Public Works have on several occasions expressed concern about the increasing amount and cost of leased space. They have advocated direct construction as the most economical way to provide space for Federal agencies.

For several years funds for construction either through direct appropriations or from General Services Federal Buildings Fund have been limited. As a result, General Services has relied on leasing as the only practicable method available to meet increased space needs. Leased space increased from 44.6 million square feet in fiscal year 1966 to 93.3 million in fiscal year 1979. There has been no appreciable increase in Government-owned space, however.

When General Services officials testified on the 1972 ID law authorizing the establishment of the Federal Buildings Fund, they estimated that \$200 to \$225 million a year would be available from the Fund for construction. From its inception in fiscal year 1975, the Fund has been unable to generate sufficient revenue to finance both operating and capital requirements. An average of only \$50 million a year has been available for construction. This is about $65 million a year less than was available through direct appropriation before the Fund was established. The present level of funding is not sufficient to (1) bring about a meaningful reduction in leased space or (2) reduce the backlog of needed projects.

Although more costly than direct Federal construction, purchase contracting is an alternative which enables General Services to borrow construction funds without the need for large single-year appropriations.

From the standpoint of the Federal Buildings Fund, direct Federal construction has a more favorable long-term budgetary impact than either purchase contracting or leasing. Purchase contracting, however, has a more favorable long-term budgetary impact than leasing.

This report presents the results of our study of the financial benefits and costs, budgetary impact, and real estate tax consequences of purchase contracting compared with direct Federal construction and leasing. Our study is based on cost and related data obtained from General Services and on discussions with officials of the Public Buildings Service. Detailed information on benefits and costs, budgetary impact, and local taxes is provided in appendix I. Our findings and conclusions concerning those issues and purchase-contracting pitfalls and options are discussed below.

FINANCIAL BENEFITS AND COSTS

As a method of financing space acquisition, purchase contracting has been used effectively to construct needed public buildings according to Federal specifications and assured eventual Government ownership of the buildings. However, purchase contracting has been more costly than direct Federal construction due to the interest rates on money borrowed to finance building construction. We could not compare fully the costs of Federal construction (purchase contracting or direct Federal construction) with leasing because of differences in building quality and cost. In general, however, federally constructed buildings provide higher quality space and entail lower interest rates on construction capital than leased buildings.

Under a 3-year purchase-contract authority granted in 1972, General Services acquired 68 buildings which, when all are completed, will provide about 15 million square feet of occupiable space. The Congress approved most of these projects for Federal construction before enactment of the 1972 purchase contract authority, but the projects lacked sufficient appropriations for construction costs. Since purchase contracting permitted General Services to borrow construction funds, it avoided the need for large single-year appropriations by the Congress to fund construction outlays. In addition, by enabling General Services to accelerate building construction, purchase contracting avoided some of the inflationary cost pressure on the approved projects. Further, most of the 68 buildings have been constructed in the same way as under direct Federal construction using appropriated funds, and building title will be assumed by the Government when the 30-year purchase contracts expire.

General Services obtained construction financing totaling about $1.3 billion for the 68 buildings through sale of participation certificates to private investors ($692 million) and the Federal Financing Bank ($5.6 million), from direct loans from the Bank ($534 million), and from financing by private developers ($111 million). Financing by participation certificates and private developers results in higher interest costs than financing by appropriated funds through long-term Treasury borrowing. For example, if Treasury borrowing, rather than sale of participation certificates to private investors, had been used, we estimate the Government would have incurred about $104 to $117 million less interest cost during the period the certificates are outstanding.

Direct loans from the Federal Financing Bank to General Services have carried interest rates of one-eighth to three-eighths of 1 percent higher than the rate on Treasury securities of comparable maturity. This rate differential is an additional cost to borrowing agencies, such as General Services, but is not a significant cost to the Government as a whole.

BUDGETARY IMPACT AND LOCAL REAL ESTATE TAXES

From the standpoint of General Services Federal Buildings Fund, direct Federal construction is the most advantageous alternative for financing space acquisition. Since only limited funds have been available for this method of financing, however, purchase contracting may be the most practicable alternative. While purchase contracting requires several more years than direct Federal construction before generating a budget surplus for the Federal Buildings Fund, it has a more favorable long-range budgetary impact than leasing. Furthermore, the budgetary impact on the Fund would be improved substantially if it were not required to bear the cost of local real estate taxes on purchase-contract projects.

The Federal Buildings Fund was established in 1972 by the Congress as a mechanism for financing public buildings operations, including new construction. Federal departments and agencies occupying space under General Services control pay annual user charges which are deposited in the Fund and made available for building operations, new construction, leasing, and other activities. Since the Fund began operations in fiscal year 1975, it has provided only about $50 million a year for meeting construction needs. By contrast, General Services in February 1979 reported a backlog of approved or pending construction projects totaling $281 million and potential projects totaling an additional $353 million. As a result of insufficient construction funds, General Services has relied increasingly on leasing rather than Government ownership in meeting space requirements.

To evaluate budgetary impact and the effect of local taxes, we analyzed Federal Buildings Fund cash receipts and outlays under direct Federal construction, purchase contracting, and leasing. Our analysis shows that:

--Compared with direct Federal construction, purchase contracting spreads out over several years the budgetary impact of construction costs. However, because user charges on purchase-contract buildings must cover interest cost and local real estate taxes in addition to construction costs and operating expenses, purchase contracting requires several more years before generating a budget surplus for the Federal Buildings Fund.

--The number of years before purchase-contract buildings generate a budget surplus would be reduced substantially if the Federal Buildings Fund did not pay local real estate taxes. Under General Services 1972 purchase-contract program, local taxes are paid during the 30-year contract period when building title is held by the contractor or trustee. Once the contract expires and title vests with the Government, tax payments cease.

--During the early years of building life, leasing is the only financing alternative which provides a budget surplus for the Federal Buildings Fund. Over the entire building life, however, purchase contracting provides a larger surplus than leasing, and direct Federal construction provides a larger surplus than either leasing or purchase contracting.

PITFALLS AND OPTIONS

On the basis of cost and budgetary impact, direct Federal construction is more effective than purchase contracting as a method of financing space acquisition. However, purchase contracting offers several benefits which, when considered in light of the limited funds available for direct Federal construction, can make it a useful financing alternative. In February 1979 a bill (H.R. 2494) was introduced which would restore for an unlimited time General Services 1972 purchase-contract authority. Also in February, a bill (S. 494) was introduced which would authorize General Services to borrow funds directly from the Treasury to finance acquisition or construction of public buildings. Based on our review of the 1972 program's costs and budgetary impact, we believe that if the Congress wants to provide General Services with a financing alternative to direct Federal construction and leasing, it should limit the agency's financing authority to direct loans from the Treasury or the Federal Financing Bank. Further, if the Congress wants the financing alternative to include payments of local real estate taxes on construction projects, it should make separate appropriations or provide direct compensation to the Federal Buildings Fund for such payments.

The major source of funds for General Services purchase-contract program has been 30-year participation certificates sold to private investors. Because these certificates bear higher interest rates than long-term Treasury bonds and Federal Financing Bank loans, they are more costly to the Federal Buildings Fund and to the Government as a whole. As we stated, the Government will incur additional interest costs in excess of $100 million as a result of General Services borrowing through participation certificates rather than directly from the Treasury. Furthermore, as we discussed in detail in our July 11, 1979, report (LCD-79-320), General Services has encountered certain debt-management problems with participation certificates. These problems, in addition to certain administrative expenses, would be avoided if the agency borrowed construction funds directly from the Treasury or the Federal Financing Bank.

Financing by direct loans from the Treasury or the Federal Financing Bank, like financing by participation certificates, could avoid the need to make large single-year appropriations to fund construction costs. As a matter of budget policy, we favor the full funding concept. As discussed in detail in our September 7, 1978, report (PAD-78-80), this concept requires the recording of total project cost as budget authority in the first year. However, since construction projects carry a low priority during times of budgetary restraint, application of the full funding concept to construction borrowing by General Services may not be practical.

Local real estate taxes on purchase-contract projects are a substantial drain on Federal Buildings Fund resources. From the inception of the purchase-contract program through the year 2004, estimated real estate tax payments are $1.3 billion. This sum represents about 30 percent of the Fund's total purchase-contract liability for principal, interest and taxes. As we have indicated, local tax payments increase substantially the number of years before purchase-contract buildings can generate a budget surplus and help the Federal Buildings Fund provide resources sufficient to meet construction needs. Furthermore, if additional purchase-contract or other financing authority were granted with a requirement for the Fund to bear the cost of local real estate taxes, the taxes on new projects would jeopardize the $50 million average annual surplus which the Fund has been providing for construction. For these reasons, the Federal Buildings Fund should be relieved of the cost of real estate taxes if the Congress decides that new legislation is needed and should include tax payments on construction projects. Relief could be provided through appropriations separate from the Fund expressly for real estate taxes, or by additional appropriations to the Fund to cover tax payments.

OTHER CONGRESSIONAL BUDGETARY CONTROL AND PROGRAM OVERSIGHT CONSIDERATIONS

Other budgetary considerations, related to congressional budgetary control and program oversight, which require attention when the Congress authorizes long-term acquisition programs involving General Services borrowings include the

- --application of the full funding concept to construction projects;
- --desirability of periodic reviews and action in the appropriation process;
- --need for legislation that provides for periodic program review, reporting, and reauthorization; and

--need for budgetary disclosure of the gross as well as net levels of borrowings.

RECOMMENDATIONS TO THE CONGRESS

If the Congress decides that new legislation is warranted granting General Services purchase-contract or other additional financing authority, it should limit General Services financing authority to direct loans from the Treasury or the Federal Financing Bank. If the Congress also decides that the Government should pay local real estate taxes on projects constructed under the new legislation, and continues to expect the Federal Buildings Fund to provide adequate resources for construction, it should offset the adverse impact of tax payments on the budget of the Fund by making either (1) separate appropriations to General Services for taxes or (2) direct appropriations to the Fund to cover tax payments.

AGENCY COMENTS

As the Subcommittee requested, this report was not submitted to General Services for written comment. A draft was discussed with agency officials, and these officials did not object to the report recommendations. However, because of the lead time before Federal buildings are available for occupancy, the officials stated that General Services will have to increase its use of leasing over the next few years to meet growing Government space requirements even if new purchase-contract authority were granted.

As arranged with the Subcommittee, we are sending copies of this report to the Administrator of General Services. Unless the Subcommittee publicly announces its contents earlier, no further distribution of this report will be made until 10 days from the date of the report.

R. F. Keller

ACTING Comptroller General
of the United States

COSTS AND BUDGETARY IMPACT OF ALTERNATIVE METHODS FOR ACQUIRING SPACE

INTRODUCTION

The Public Buildings Act of 1959 (40 U.S.C. 602) authorizes the Administrator of General Services to acquire public buildings by purchase, condemnation, donation, or exchange. The Federal Property and Administrative Services Act of 1949 (40 U.S.C. 490) authorizes the Administrator to lease, for periods up to 20 years, existing buildings or buildings to be erected for Government use by private or public lessors. The General Services Administration (GSA) controls approximately 232 million square feet of space, of which about 60 percent is Government-owned and 40 percent is leased.

Purchase-contract authority

Both the Public Buildings Purchase Contract Act of 1954 (Public Law 83-519) and the Public Buildings Amendments of 1972 (Public Law 92-313) contain 3-year purchase-contract authority that enabled GSA to enter into contractual arrangements for the construction of a backlog of approved, but unfunded, projects. Under these acts, GSA obtained financing of $1.4 billion for 97 projects by two financing methods.

Under a package method, GSA entered into agreements with contractors for the construction and financing of 52 small-building projects: 29 under the 1954 act 1/ and 23 under the 1972 act, with combined financing of $146.7 million. GSA makes semiannual payments to the contractors for interest, real estate taxes, and amortization of principal. At the end of the contract period, title to the buildings vests with the Government.

Under a dual method, GSA contracted separately for the construction and financing of 45 building projects under the 1972 act. Financing of $691.5 million was obtained through the sale of participation certificates and about $534 million was borrowed from the Federal Financing Bank. Construction contracting under the dual method has been done in the same way as under direct Federal construction using appropriated funds. As in the case of package-method financing, GSA pays

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1/Payments are completed on 24 of the 29 projects.

real estate taxes to help ease the burden of the Federal presence on the local community during the purchase-contract term. Dual-method financing with participation certificates is discussed in more detail in our July 11, 1979, report (LCD-79-320).

Estimated purchase-contract payments from the inception of the program through the year 2004 are $4.443 billion.

	(billion)
Principal and interest	$3.107
Real estate taxes	1.333
Administrative expenses	.003
Total	$4.443

In 1957 legislation was introduced in both Houses of Congress to extend the GSA purchase-contract authority under the 1954 act for an additional 3 years. The then House Committee on Public Works was opposed to such an extension because it considered the purchase-contract program uneconomical in comparison with direct Federal construction. Further, physical construction had started on only one building in the 3 years following passage of the 1954 act.

The 3-year authority in the 1972 act expired June 30, 1975. A bill (H.R. 2494) introduced on February 28, 1979, would restore the purchase-contract authority of the 1972 act, but would not provide an expiration date. Accordingly, if the bill were enacted, purchase contracting would be made available to GSA indefinitely to finance building acquisition. Another bill (S. 494) introduced on February 26, 1979, would authorize the Administrator to borrow money from the Secretary of the Treasury for periods up to 30 years to finance acquisition or construction of public buildings. If enacted, this bill would not restore to GSA the purchase-contract authority contained in the 1972 act.

Federal Buildings Fund

Since fiscal year 1975, annual purchase-contract payments have been financed from the Federal Buildings Fund, which was established pursuant to section 3 of the 1972 act. The act also authorizes the Administrator to charge agencies user rates for space occupied and services received. According to the law, the rates shall approximate commercial charges for comparable space and services. 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.

For fiscal year 1980, estimated collections from user charges are $1.511 billion and other income is $3 million for a combined Fund income of $1.514 billion. New obligational authority is estimated at $1.421 billion to be applied to the following real property activities:

	Amount	Percent
	(millions)	
Construction and acquisition of facilities	$ 16.287	1.1
Alteration and major repairs	180.000	12.7
Purchase contract payments	99.700	7.0
Rental of space	554.600	39.0
Real property operations	498.063	35.1
Program direction	72.472	5.1
Total	$1,421.122	100.0

In considering the establishment of 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 it. It also was believed that the Fund would generate sufficient moneys for capital expenditures. GSA estimated that the Fund would provide $300 million a year for capital expenditures, of which $200 to $225 million would be available for construction. From 1959 to 1971, before the Fund was established, GSA received direct appropriations for construction averaging about $115 million a year. This amount was considered inadequate to meet Federal construction needs. For example, GSA pointed out during hearings on the 1972 purchase-contract legislation that, with annual appropriations averaging only $115 million, at least 10 years would be required to eliminate the backlog of construction projects already approved by the Congress. The agency also noted that inflation was rapidly increasing the costs of constructing those projects.

In recommending passage of the 1972 act, the House Committee on Public Works held that purchase contracting was only a stop-gap measure and that the Federal Buildings Fund should eventually provide adequate resources to finance construction needs. The Committee stated:

> "The three-year purchase-contract authority in H.R. 10488, as reported, is a stop-gap expedient, an attempt to reconcile the urgent need for new Federal facilities with present economic conditions. Congress has repeatedly asserted its insistence upon the direct Federal construction of public buildings required by the Public Buildings Act of 1959.
>
> "Direct Federal construction is the most efficient and economical means of meeting Government building needs. Nevertheless, the futility of seeking a billion dollars for direct Federal construction of the present backlog of 63 buildings in competition with the present spending priorities, together with the urgency of the need for these facilities, makes clear that the best course is to permit GSA to construct the presently authorized buildings over a relatively short term, then return to direct Federal construction through the medium of the public buildings fund. * * *"

Since the Fund began operations in fiscal year 1975, it has not provided sufficient funds for construction. Only $251.6 million was available for Federal construction in fiscal years 1975 through 1979, an average of $50.3 million a year. As discussed in greater detail below, federally constructed buildings generally cost more than private buildings providing comparable space. Since GSA user charges are based on comparable commercial rates, several years are required before the higher Federal construction costs, in addition to building financing and operating costs, can be recovered through user charge income.

Increased reliance on leasing to meet space needs

There has been a sizable increase in leased space under GSA control since fiscal year 1966, but no appreciable increase in Government-owned space acquired through direct Federal construction. Leased space increased from 44.6 million square feet in fiscal year 1966 to 93.3 million in fiscal year 1979. Annual lease payments increased from $131 to

$520 million during the same period, and this trend is expected to continue. As previously shown, annual lease payments will account for 39 percent of estimated Federal Buildings Fund new obligations in fiscal year 1980.

Budgetary restrictions was the major reason for increased leasing when construction was funded through direct appropriations. The large initial outlays for Federal construction affect the national budget in the year that appropriations are approved. In times of unusually large demands on the budget, construction projects were the first items to be eliminated.

The House and Senate Committees on Appropriations and on Public Works have, on several occasions, expressed concern about the increasing amount and cost of leased space. They have advocated construction as the most economical way to provide space for Federal agencies. GSA, however, has to rely on leasing to meet increased space needs. The average annual level of construction funding of about $50 million a year provided by the Federal Buildings Fund is not sufficient to (1) bring about a meaningful reduction in leased space or (2) reduce the backlog of needed projects. In this regard, the Administrator, in a February 9, 1979, letter to the Chairman, House Committee on Government Operations, stated:

> "While there is no doubt that an increasingly proportionate share of space provided by GSA is being leased, the continually increasing space requirements, without corresponding increases in appropriations for Federal construction, necessitate the need to provide space through the lease acquisition process. As an example, our average annual construction appropriation for the last 3 fiscal years has been about $44 million. When considering the fact that we currently have projects approved or pending totaling $281 million, with $383 million worth of potential projects, it is clear that the only available means of providing for necessary requirements is through leasing. * * *"

COSTS OF PURCHASE CONTRACTING COMPARED WITH DIRECT FEDERAL CONSTRUCTION AND LEASING

A major cost difference among direct Federal construction, purchase contracting, and leasing is the interest rate associated with the money borrowed to construct the buildings.

The cost of capital for direct Federal construction--as measured by the interest rate on long-term Treasury bonds--is lower than the interest rate on GSA participation certificates used in purchase contracting and the interest rate on borrowings used by private developers in leasing buildings to GSA. We could not compare fully the overall costs of federally constructed buildings (direct Federal construction and purchase contract) with leasing because of differences in the quality and cost of the buildings.

Purchase contracting has been less cost effective than direct Federal construction because financing by participation certificates or private developers is more costly than direct Treasury borrowing. Agency loans from the Federal Financing Bank, the third source of GSA purchase-contract financing, has entailed interest rates of one-eighth to three-eighths of 1 percent higher than the rate on new marketable Treasury securities of comparable maturity. This higher rate is an additional cost to GSA, but it is not significant from the standpoint of the Government as a whole because part of the higher rate has accumulated as profit to the Bank. The rate also defrays the cost of the Bank's administrative services. This cost would be greater if the Bank had not been created and agencies such as GSA had continued to sell debt securities directly to private investors.

GSA obtained financing of $691.5 million through the sale of series A-I participation certificates to private investors at interest rates ranging from 7.15 to 8.125 percent. On the basis of market conditions at the time the GSA certificates were sold, we estimated that the Treasury could have issued long-term Government bonds for three-fourths of 1 percent less than the effective interest rate for the certificates. As a result, the Government will incur additional interest costs of about $104 to $117 million while the participation certificates are outstanding.

Apart from the higher financing cost associated with purchase-contract buildings, GSA pays real estate taxes until building title vests with the Government. Real estate taxes through the year 2004 are estimated at $1.3 billion. Real estate taxes are not paid on Government-owned buildings, but are included in cost comparisons as an imputed cost of Government ownership under the rationale that other Federal support may be required to compensate the State and/or local governments for real estate tax revenues lost.

GSA analyses of purchase contract costs

In supporting the 1972 act, GSA listed a backlog of 63 projects which were to be financed through purchase contracting. These projects had been previously approved for Federal construction by the then House and Senate Public Works Committees, but had not been funded. For various reasons, GSA withdrew 12 projects and added 17 that were later individually approved by the Committees.

GSA included present value analyses with 13 of the 17 project prospectuses. Most of these analyses were prepared in accordance with the procedures, assumptions, discount rate, and format in the Office of Management and Budget (OMB) Circular A-104, dated June 14, 1972. Nine of the 13 analyses contained a three-way comparison of purchase contracting, direct Federal construction, and leasing.

According to the nine GSA analyses, purchase contracting was the least costly alternative for four projects, and leasing was the least costly for the other five. In no case was direct Federal construction shown by GSA to be the most favorable alternative.

Although GSA showed leasing to be least costly for five projects, it did not consider leasing viable for one or more of the following reasons:

--The best interests of the United States would be served by providing for the construction of the new building by purchase contracting.

--Office space was not available in sufficient quantity in one building or complex to satisfy the Government requirements.

--Suitable leased space meeting the unique technical requirements was not available in an existing building.

GSA cost estimates did not recognize timing of cash outlays for direct Federal construction

The most appropriate way to evaluate the cost of investment alternatives is to compare the discounted present value of the future cash outlays. In calculating present value, it is important that future outlays are discounted to correspond with the expected timing of cash payments. In our February 13, 1975, report (LCD-74-334), we pointed out that construction payments begin only after contract award and continue throughout the construction period of about 3 years. In its present value analyses, however, GSA did not recognize fully the timing of future Federal construction payments. In effect, it assumed that those payments were made in a lump sum at the analysis date. As a result, GSA's estimated cost of direct Federal construction was overstated compared with its estimated costs of purchase contracting and leasing.

Appendix II shows GSA's present value analyses of leasing, purchase contracting, and direct Federal construction for four of the projects included in prospectuses submitted to the Congress. In each analysis, purchase contracting was presented as the least costly alternative. Appendix II also shows adjustments which we made to GSA's estimated cost of direct Federal construction. Our adjustments are based on the estimated interest rate and timing of Treasury financing that would have occurred under the assumption that GSA construction payments are spread out over 3 years and each payment is financed by long-term (30-year) Treasury bonds. When computed on this basis, the present value cost of direct Federal construction for all four projects is about $130 million compared with the GSA estimate of about $175 million. If GSA in its analyses had discounted construction costs to correspond more closely with the timing of its cash payments over a 3-year period and had discounted those payments at the interest rate we used, it would have shown direct Federal construction as the least costly alternative for each project.

We also found that GSA, in addition to not recognizing fully the timing of construction outlays, had revised cost data on one of the four projects to support purchase contracting as the least costly alternative. (See app. III.)

Lack of comparability between federally constructed and leased buildings

Economic analyses comparing the costs of Federal construction and ownership with leasing are not fully comparable because of the differences in the quality and cost of Government owned and leased buildings. These differences are not cited in the GSA analysis submitted to the Congress.

Prior engineering studies indicate that Federal buildings cost more than leased buildings for the same amount of occupiable space. Federal buildings generally have higher ceilings, more area for elevators and other services, and better quality materials and mechanical equipment. As we pointed out in our November 4, 1975, report (LCD-75-345), GSA construction contract provisions, resulting from specific acts of Congress, also increased the costs of Federal buildings. For example, the Davis-Bacon Act (41 U.S.C. 276a) imposes minimum wage standards on certain Federal construction contracts and the Buy American Act (41 U.S.C. 10) and related measures exclude use of construction materials from foreign sources which may be less costly than domestic materials. Since such contract provisions do not apply to commercial buildings, similar cost increases do not occur.

Another difference which affects comparability is that the GSA analyses included estimated cost for repairs and improvements as part of the Federal construction and ownership alternatives. GSA also invests sizable amounts for improvements in leased buildings, but its analyses do not include a factor for these costs under the leasing alternative.

BUDGETARY IMPACT OF PURCHASE CONTRACTING ON THE FEDERAL BUILDINGS FUND COMPARED WITH DIRECT FEDERAL CONSTRUCTION AND LEASING

While an analysis comparing the discounted present value of future cash outlays is the appropriate way of evaluating the cost of investment alternatives, an analysis comparing future receipts and outlays on an undiscounted basis is helpful for assessing the budgetary impact of the alternatives. From the standpoint of the budget of the Federal Buildings Fund, direct Federal construction is the most advantageous alternative for financing space acquisition. This method requires large initial cash outlays for construction costs, but over the long term requires less Fund resources and provides a larger budget surplus than either purchase contracting or leasing.

Purchase contracting spreads out over several years the budgetary impact of construction outlays. Due to interest payments and local real estate taxes, however, it requires a greater number of years than direct Federal construction before generating a budget surplus for the Federal Buildings Fund. If the Fund did not pay local real estate taxes on purchase-contract projects, the budgetary impact of purchase contracting would be improved substantially.

Leasing generates a larger budget surplus than either direct Federal construction or purchase contracting during the early years of building life. Over the entire building life, however, the surplus provided by leasing is smaller.

Procedures used to analyze budgetary impact

The longer the period before building receipts from standard level user charges (SLUC) exceed building construction, financing, and operating costs, the longer the Federal Buildings Fund must wait before accumulating resources to finance needed construction and improvements. Conversely, the shorter the period, the sooner a building will generate a budget surplus and contribute to the Fund's resources.

To analyze the budgetary impact of purchase contracting on the Federal Buildings Fund, we projected over several years the cash receipts and outlays resulting from the construction, financing, and operation of eight purchase-contract buildings. Cash receipts to the Fund consist of SLUC income, and cash outlays consist of principal and interest, taxes, and operating expenses (comprised of operations and maintenance, major repairs and alterations, and other expenses).

Each of the buildings examined was at least 95-percent occupied during the final quarter of fiscal year 1978 and was financed by participation certificates sold to private investors or the Federal Financing Bank. Further, as shown below, based on GSA data the buildings had SLUC receipts in 1978 that exceeded outlays for operating expenses, but not the additional outlays for principal, interest, and taxes. In total, the buildings generated a negative cash flow to the Federal Buildings Fund of about $10.5 million. 1/

1/Of the 68 purchase-contract projects financed under the 1972 act, 21 were at least 95-percent occupied during the final quarter of 1978 and had had at least one annual payment of principal and interest made by the Federal Buildings Fund. SLUC receipts in 1978 for each of these projects exceeded outlays for operating expenses. In no case, however, did SLUC receipts exceed outlays for operating expenses and principal, interest, and taxes. In total, the 21 projects had a negative cash flow of about $16.7 million. This amount would be increased if all GSA administrative and management costs were allocated to individual buildings. If all 68 projects had been completed and at least 95-percent occupied in 1978, we estimate that total negative cash flow would have exceeded $45 million.

Cash Flow of Eight Purchase-Contract Buildings in Fiscal Year 1978

	Amount
SLUC receipts	$20,958,476
Less outlays for operating expenses (note a)	9,724,491
Cash flow to Federal Buildings Fund before principal, interest, and taxes	11,233,985
Less outlays for principal, interest, and taxes	21,693,444
Negative cash flow to the Federal Buildings Fund	-$10,459,459

a/Includes operations and maintenance, major repairs and alterations, and other expenses.

Because accurate historical data is limited, we estimated future annual SLUC receipts, operating expenses, and local real estate taxes based on fiscal year 1978 data only. These receipts and outlays were projected by escalating 1978 amounts by two factors: 3.6 percent a year, the average annual rate of increase in the Consumer Price Index from 1953 through 1978 and 8 percent a year, the average annual rate from 1973 through 1978. According to GSA analyses, building receipts, operating expenses, and taxes have varied at about the same rate as general price inflation. Annual outlays for principal and interest were projected based on the terms of the trust indenture under which the relevant participation certificates were sold. These outlays were not inflated since they are set by indenture.

Our procedures gave two sets of cash-flow projections for the eight buildings reflecting different assumptions about future inflation. Based on the projections, we then determined each building's estimated

--breakeven period, defined as the building age in years when annual cash receipts first exceed annual outlays and

--recovery period, defined as the building age in years when cumulative cash receipts exceed cumulative outlays.

In addition, to determine the effect of real estate taxes on purchase-contract breakeven and recovery periods, we adjusted our cash-flow projections to remove tax payments.

Because our projections entail assumptions about future inflation, are based on limited historical data, and apparently include some inaccurate base-year operating costs for individual buildings, 1/ projected breakeven and recovery periods must be viewed as approximations.

To compare purchase contracting with direct Federal construction, we removed payments of principal, interest, and taxes from the cash-flow projections for the eight buildings and assumed that construction outlays had been paid from Federal Buildings Fund resources.

To compare purchase contracting and direct Federal construction with leasing, we adjusted building cash-flow projections based on a previous GSA study of lease costs. GSA's study found that receipts from leased buildings exceed expenses (including GSA program direction) by an average margin of 2 percent per year throughout the lease term. Thus, a typical leased building reaches the breakeven point in the first year of occupancy and provides a budget surplus to the Federal Buildings Fund in each subsequent year. 2/

Results of budgetary impact analysis

The chart on page 13 summarizes our findings concerning cash-flow breakeven and recovery periods. It shows (1) the estimated average recovery period of purchase contracting compared with direct Federal construction and (2) the effect of local real estate taxes on the average purchase-contract breakeven and recovery periods. Estimated averages have been weighted by building occupied square footage in 1978

1/For example, one of the buildings we examined had an extraordinarily large utility expense in fiscal year 1978. According to GSA officials, the building may have been charged with utility costs actually generated by separate Federal facilities in the same area. Consequently, while reported costs may be accurate on an aggregate basis, they may be understated or overstated for an individual building.

2/Our treatment of leasing implicitly assumes that leased buildings provide quality of space comparable to Government-owned buildings. However, as previously stated (see p. 8), a federally constructed building generally provides higher quality space than a leased building of comparable cost.

and are shown under assumptions of 3.6 percent and 8 percent annual inflation.

Estimated Cash-Flow Recovery Period of Purchase Contracting Compared with Direct Federal Construction and The Effect of Local Real Estate Taxes on Purchase-Contract Breakeven and Recovery

Financing method and cash-flow period	Average building age in years (note a) 3.6% annual inflation	8% annual inflation
Purchase contract recovery	39	27
Direct Federal construction recovery	17	14
Net advantage of direct Federal construction	22	13
Purchase contract, including local real estate taxes:		
Breakeven	26	20
Recovery	39	27
Purchase contract, excluding local real estate taxes:		
Breakeven	20	11
Recovery	32	19
Increase due to local real estate tax payments:		
Breakeven	6	9
Recovery	7	8

a/Averages are weighted by occupied square footage in fiscal year 1978 and are based on cash-flow projections for eight purchase-contract buildings at least 95-percent occupied during the final quarter of 1978. The inflation factors were applied to SLUC income, operating expenses, and taxes, but not purchase-contract principal and interest payments.

The data in the charts show that:

--Assuming 3.6-percent annual inflation, purchase contracting on an average takes about 22 years longer than direct Federal construction to recover building construction, financing, and operating costs. Assuming 8-percent inflation, purchase contracting on an average takes about 13 years longer.

--If the Federal Buildings Fund did not pay local real estate taxes on purchase-contract projects, the average cash-flow breakeven period of purchase contracting would be reduced by about 6 years (3.6-percent inflation) or 9 years (8-percent inflation). Similarly, the average recovery period would be reduced by about 7 or 8 years.

The graph on page 15 depicts projected cash flows to the Federal Buildings Fund under purchase contracting, direct Federal construction, and leasing. The average cumulative cash flow (positive or negative) per square foot of occupied space is given by building age, based on an 8-percent inflation rate. 1/ The graph shows that:

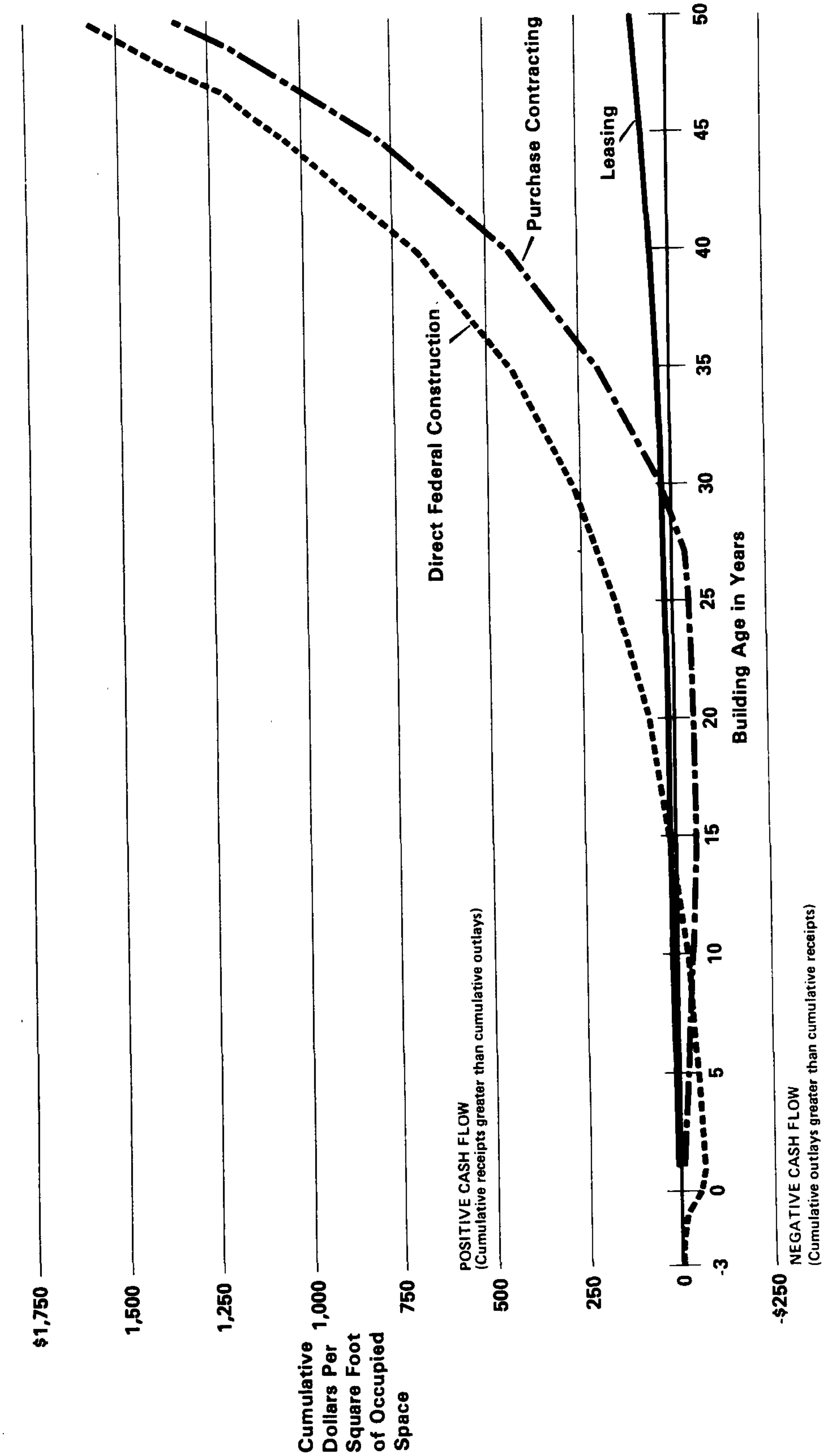
--During the early years of building life, only leasing provides a positive cash flow for the Federal Buildings Fund.

--Beyond the early years of building life, direct Federal construction provides the largest cumulative cash flow for the Federal Buildings Fund. Buildings acquired by direct Federal construction generally begin to generate income in excess of operating expenses in their initial year of occupancy. Several years are required, however, before building income fully recovers construction outlays and cumulative cash flow becomes positive.

--Over the entire building life, purchase contracting provides a substantially larger cumulative cash flow than leasing, and direct Federal construction provides a larger cumulative cash flow than either leasing or purchase contracting.

1/An inflation rate other than 8 percent would change the location of each cash-flow function depicted in the graph, but would not materially alter the position of one function in relation to the others.

Estimated Cumulative Cash Flow to the Federal Buildings Fund By Building Age Under Purchase Contracting Direct Federal Construction, and Leasing



APPENDIX II

SUMMARY OF PRESENT VALUE ANALYSES

OF ALTERNATIVES FOR FOUR BUILDINGS

Building	Amount reported by GSA for Leasing	Purchase contracting	Direct Federal construction	Amount for direct Federal construction as adjusted by GAO (note a)
	--------	(000 omitted)	--------	
Richmond, California	$ 46,510	$ 45,499	$ 50,388	$ 38,104
Chicago, Illinois	62,305	56,100	62,587	46,344
Philadelphia, Pennsylvania	47,080	36,454	40,514	29,973
Columbus, Ohio	18,874	18,807	21,227	15,300
Total	$174,769	$156,860	$174,716	$129,721

a/In its present value analyses of direct Federal construction costs, GSA assumed that its construction payments would occur in a lump sum at the analysis date. Our adjustments are based on the assumption that those payments would be spread out over 3 years and that each payment would be financed by 30-year Treasury bonds carrying an interest rate of three-fourths of 1 percent lower than the rate on the purchase-contract participation certificates under which each project was actually financed. We then discounted Treasury's future outlays for interest and principal to determine their present value. Because the GSA estimates for leasing and purchase contracting include a price deflator to show future payments in constant dollars, we also included the deflator in our adjustments to provide comparability. If GSA had discounted its payments for Federal construction to correspond with the 3-year construction period and had discounted those payments at the same interest rate we used, its estimates would have shown direct Federal construction as the least costly alternative for each building.

ADJUSTMENTS OF COST ESTIMATES

FOR COLUMBUS, OHIO, PROJECT

The project prospectus, which GSA sent to the Congress in September 1972, included a present value analysis supporting purchase contracting as the least costly alternative for project acquisition. However, an earlier analysis showed leasing to be the least costly method. On July 18, 1972, a meeting was held in the Office of the Acting Commissioner, Public Buildings Service, concerning purchase-contract financing for the project. It was decided at that meeting that cost adjustments in the analyses would be required before purchase contracting could be supported for the project. The present value analysis was then revised to show purchase contracting as the least costly method of financing.

A comparison of the initial and revised amounts for alternative methods of project acquisition follow:

Alternative	Initial analysis	Revised analysis	Increase or decrease (-)
	(million)		
Federal construction	$28.302	$21.227	-$7.075
Purchase contracting	25.187	18.807	- 6.380
Leasing	16.406	18.874	2.468

In a July 20, 1972, memorandum to the record, a GSA realty officer stated:

> "* * * in view of direction to submit the prospectus proposing purchase contracting, a thorough review has been made. As a result, cost adjustments would be required if purchase contracting was to be supported. * * * I was instructed to revise the prospectus which has been prepared reflecting leasing, to reflect purchase contracting as the method of financing."

In summary, present value analysis is appropriate for evaluating the comparative cost of investment alternatives, provided that the underlying assumptions and criteria are realistic and are applied objectively and consistently. Like any other analytical technique, however, a present value analysis can be adjusted by varying assumptions or criteria to support a particular course of action. In this case, it appears that the analysis was adjusted simply to rationalize a decision already made.

Committee on Public Works and Transportation

Congress of the United States
House of Representatives
Room 2165, Rayburn House Office Building
Washington, D.C. 20515
TELEPHONE: AREA CODE 202, 225-4472

March 19, 1979

Honorable Elmer B. Staats
Comptroller General of the United States
General Accounting Office
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Staats:

As you may know, we recently introduced a bill, H.R. 2494, which would amend the Public Buildings Act of 1959 relating to leases, alterations, and exchanges, and for other purposes. This bill was introduced in order to provide for a more close Congressional scrutiny of repair and alteration of Federal buildings and of leasing private office space for Federal use. Additionally, this bill would restore the purchase contract authority that was contained in the Public Buildings Amendments of 1972, Public Law 92-313.

This purchase contract authority expedited the construction of 68 Federal buildings that had been authorized prior to enactment of Public Law 92-313 but not funded. We are again facing this problem of a backlog of necessary Federal construction to house Federal agencies. In this regard, the President's Fiscal Year 1980 Budget proposes only $16.28 million for new construction and acquisition activities of the Public Buildings Fund, less than the budget request for fiscal year 1979. Of that amount, only $8.5 million would actually be available for new construction because $7.058 million would be utilized for the acquisition of Postal Service properties.

The Subcommittee on Public Buildings and Grounds proposes to hold hearings in the near future on this bill and related bills and in preparation for those hearings, we are hereby requesting that you conduct a study to compare the purchase contract method of construction of Federal buildings with the lease construction arrangement that the General Services Administration currently uses with private developers. This study should contain, among other things, an analysis of the financial benefits and costs of both, the budgetary impact, the secondary impact on local tax structure, and the question of Federal ownership of office space versus the two aforementioned methods. In addition, we would appreciate your looking at all options and possible pitfalls with respect to the 1972 purchase contract program.

We are requesting an identical study by the General Services Administration as a second opinion in the matter, so that we may more effectively evaluate the matter from different standpoints. We would be most appreciative if you could give this request priority as we will need it as soon as possible in order to be able to evaluate all studies prior to hearings by the Subcommittee.

Very truly yours,

JAMES D. ABDNOR
Ranking Minority Member

ELLIOTT H. LEVITAS
Chairman, Subcommittee on
Public Buildings and Grounds

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