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The Disinvestment in Federal Office Space

Statement of
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THE DISINVESTMENT IN
FEDERAL OFFICE SPACE

SUMMARY OF STATEMENT BY
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OPERATIONS ISSUES

For a variety of reasons, the federal government has neglected, for nearly 2 decades, the need for capital investment in modern, quality working space for its employees. Needed repair and modernization projects as well as construction have been deferred. This failure to invest sufficiently in public buildings is beginning to impede the capability of federal agencies to carry out their missions.

Another major consequence is the steadily rising dependence on costly leased office space. More and more revenue that could be used to finance needed capital investment is being siphoned off to meet spiraling annual lease costs--$1.2 billion today and projected to rise to $2 billion in the mid-1990s.

GAO recently issued a series of three reports which emphasized that billions of dollars could be saved if the government owned more of its office buildings rather than leased them. Based on these reports and its general management review of GSA, GAO has identified five principal obstacles to increased capital investment in public buildings: (1) GSA's lack of a strategic concept of its role, including a long-term strategic buildings plan; (2) GSA's pervasive management information systems' problems; (3) the congressional project authorization process that forces both GSA and Congress to think on a transactional project-by-project basis; (4) the inability of the Federal Buildings Fund to finance long-term capital investment needs; and (5) an inherent budget bias against increased federal ownership of space when compared to leasing.

The $3 billion construction program proposed by GSA and OMB for congressional consideration illustrates the effect of these obstacles. Not only is the lease-purchase financing mechanism considerably more expensive than direct financing, but Congress also has no assurance that the projects meet the most critical long-term needs.

GAO makes several recommendations for a more foresighted, cost-effective approach to meeting federal space needs.

Mr. Chairman and Members of the Subcommittee:

We welcome this opportunity to appear before you today in connection with your oversight of the General Services Administration's (GSA) public buildings program. My testimony summarizes a body of work that provides grounds for serious concern about the federal government's current ability to provide quality office space for its employees at a reasonable cost.

One of the serious consequences of budget deficits has been to shortchange the investment required to efficiently maintain government operations. Pervasive shortfalls in funds for financing the basic infrastructure for providing government services -- such as facilities, people, and computers -- threatens to compromise the ability of federal agencies to accomplish their missions.

Public buildings, the subject of your hearing today, provides one of the principal examples of disinvestment in the government's infrastructure. For a variety of reasons, the government, for nearly 2 decades, has neglected the need for capital investment in modern, quality working space for its employees. Available evidence suggests that this was short-sighted, that agencies' mission accomplishment as well as employees' morale and productivity can be adversely affected, and that a major infusion of funds will now be required to compensate for this neglect. A classic case in point is the serious deterioration of the nearly 50-year-old Pentagon building and the estimated $1 billion that will be needed to bring it up to acceptable standards.

A September 1989 joint OMB/GSA study of federal building needs and financing options concluded that a cumulative Federal Buildings Fund revenue shortfall of $4 billion (in 1989 dollars) since 1975 resulted in a backlog of major repair and modernization projects in existing public buildings and a significant deferral of new construction projects to meet long-term space needs. This study noted major challenges in maintaining over 1,600 government-owned buildings because they generally need a major system overhaul every 20 years, and more than half of them are over 40 years old. Also, many of them are monumental in design and historically significant.

Another consequence of shortchanging investment in facilities is the steadily rising dependence on costly leased office space. Since 1969, for example, leased office space has grown by 103 percent, and the ratio of leased to owned office space has risen from 39 percent to 47 percent. Similarly, the costs of leased space have skyrocketed from $389 million in 1975 to $1.2 billion today and are projected by GSA to reach $2 billion by the mid-1990s as more old leases expire and are renewed at today's inflated prices. More and more revenues that could be used to finance needed capital investments are being siphoned off to pay spiraling lease bills.

Because of deferred capital investment in needed repairs and modernization as well as in new construction, we sense that agencies are becoming increasingly dissatisfied with their space. Also, agencies are placing increasing demands on GSA for different and better space as the nature of office work changes. More and more tenant agencies and their congressional supporters are perceiving their space as well as GSA's facilities management program to be detrimental to their mission accomplishment and are attempting to go it alone. Out of frustration, they are chipping away at GSA's public buildings authority. The Pentagon is breaking away from GSA, and the courts are making a serious bid to follow.

At your request, Mr. Chairman, and three of your Senate colleagues, we recently issued a series of three reports on the effectiveness of GSA's efforts to improve the ratio of government-owned to leased space:

-- In our first report, Public Buildings Service: GSA's Projection of Lease Costs in the 1990s (GAO/GGD-89-55, Apr. 19, 1989), we analyzed GSA's projection that the cost of leasing space would increase from $900 million in 1986 to $2 billion by 1995. We found that some of the data used to make the projection was unreliable, although the model used to make the projections was basically sound.

-- In our second report, Building Purchases: GSA's Program Is Successful But Better Policies and Procedures Are Needed (GAO/GGD-90-5, Oct. 31, 1989), we examined GSA's building purchase program. Our major message was that although building purchases need to be better managed, the program has proven to be an economical means for acquiring office space. While GSA agreed with our findings, conclusions, and recommendations, we should point out that its fiscal year 1990 and 1991 budgets include no new funds for building purchases.

-- Finally, in our third and perhaps most important report of the series, Federal Office Space: Increased Ownership Would Result in Significant Savings (GAO/GGD-90-11, Dec. 22, 1989), we concluded that GSA could meet federal office space needs more economically through ownership rather than leasing but recognized several impediments to that approach. We made several recommendations to GSA as well as Congress that were designed to facilitate increased federal ownership.

Also, we have just completed a general management review of GSA. In our report, General Services Administration: Sustained Attention Required To Improve Performance (GAO/GGD-90-14, Nov. 6, 1989), we concluded, among other things, that (1) GSA needs to assume a greater central management leadership, policy guidance, and oversight role in the public buildings area but (2) GSA's management practices and systems would not allow it to successfully complete such a role change and thus improve its performance. We made a number of recommendations designed to enable GSA to assume a policy guidance and oversight role more effectively.

OBSTACLES TO INVESTMENT IN FEDERAL BUILDING NEEDS

On the basis of this body of work, we derived what we believe are five principal obstacles to effectively meeting federal space needs. These obstacles have serious economic, political, and/or sociological consequences.

No long-term strategy

First, as emphasized in our November 1989 general management report, GSA lacks a strategic concept of its public buildings role. Because of its historical predilection toward operations, to the neglect of its central management functions, GSA developed a practice of thinking and planning on a short-term, reactive, and transactional project-by-project basis that persists today. GSA still lacks a comprehensive long-term plan that promotes more strategic thinking about the proper mix of owned and leased buildings and identifies and prioritizes total short and long-term federal space needs as well as the most economical way of meeting them. This compromises GSA's credibility and prevents it from fulfilling its intended central management role.

GSA's lack of a strategic concept of its role also hampers congressional oversight and decision-making. Without a capital investment strategy that identifies total short and long-term space needs, relative priorities, and funding requirements as well as financing alternatives, Congress cannot (1) systematically and rationally identify the most critical or most cost-beneficial projects to be constructed or renovated, (2) monitor GSA's performance in meeting overall space needs, or (3) anticipate future capital investment funding requirements.

Accordingly, our December 1989 report on GSA's efforts to increase federal ownership of space recommended, among other things, that GSA prepare annual long-range facility plans that identify total space needs and the most economical means of meeting them. Since GSA has not yet done that and the 20 new construction projects GSA is proposing to initiate between fiscal years 1991 and 1993 did not emanate from such a plan, Congress cannot effectively judge whether (1) the proposed projects meet the highest priority needs and (2) the creative financing techniques GSA is proposing are worth the added costs.

GSA's lack of a comprehensive capital investment strategy of its own encourages others to substitute their own agendas. For example, the absence of a GSA strategy invited OMB throughout the 1980s to impose a general policy of owning only courthouses, departmental headquarters buildings, and some special purpose space such as laboratories and to lease all other space -- a policy colored by OMB's goal of reducing the size and role of government. It also places GSA in a weak position to counter the tendency of individual Members of Congress to place buildings in their own states or districts. The lack of a comprehensive investment strategy also encourages GSA's short-sighted tendency to allocate projects somewhat equally among its regions for internal political reasons.

Unreliable information systems

Secondly, our general management review and other reports pointed out that GSA has pervasive management information systems problems which seriously restrict its ability to manage public buildings effectively. Its information systems supporting public buildings activities do not produce accurate or timely management information or contain all needed data. Consequently, they do not permit forward thinking or informed decision-making. For example, our general management report pointed out that GSA senior executives were not getting the financial and program information they needed to do strategic planning, assess progress toward agency goals and objectives, analyze and forecast trends, or exercise executive control over GSA's multifaceted businesses. Without reliable, accurate, and timely information, GSA cannot effectively plan, manage, or oversee federal space needs.

The prospectus authorization process

The congressional prospectus authorization process is a third obstacle. It forces both GSA and Congress to think on a prospectus-by-prospectus basis. GSA is required by law to develop and submit to the Public Works Committees a prospectus for each capital investment project expected to cost over $1.5 million. Each prospectus stands on its own and does not mention other competing projects. The Public Works Committees, understandably, consider prospectuses individually without data on total capital investment needs, the relative priorities of competing projects, or the availability of funding. This individual transaction focus mitigates strategic thinking, can result in irrational spending decisions, and can open the door to undue political influence. One of the principal arguments OMB has made over the years against capital investment initiatives is what it perceives as a pervasive tendency for Congress to treat them as a pork barrel.

Funding shortfalls

A fourth major obstacle to increased capital investment is funding shortfalls. Although the Federal Buildings Fund was set up to provide revenues for capital investment, it has largely failed to do so. Between 1975 and 1988, for example, the Fund generated an average of only $97 million per year (in constant 1988 dollars) for construction and acquisition. The inadequacy of this funding level is apparent when it is compared to the estimated $3 billion in funding required to construct the 20 buildings GSA wants to initiate between fiscal years 1991 and 1993. One reason for the deficient revenues is that OMB and Congress have periodically restricted the rent GSA charges tenant agencies. Since the Fund was established in 1975, rent restrictions have reduced its revenue by $4 billion (in 1989 dollars). This is money that could have been used to finance capital investment.

The current budget process

The final and perhaps most important obstacle is the inherent bias against capital investment built into the current federal budget process. The budget system is inherently biased because of the disadvantage ownership investments face due to the need to recognize and record total costs over a relatively short period. In contrast, other costs, such as leasing costs, can be spread out over a much longer period. For example, the entire costs of constructing a building are outlayed during the few years of construction, but only one year's rent has to be outlayed for a leased building even though the government is obligated to continue making those annual payments over the entire period of the leases. As a result, the budget process places ownership projects at a distinct disadvantage during budget deliberations. These projects must compete with other means for acquiring space, such as leasing, which show up in the budget as much lower initially but commit the government to significantly higher long-term costs. Consequently, GSA and Congress have typically selected the leasing option which is actually more costly over the long term.

As we reported to you in December 1989, billions of dollars could be saved if the federal government owned office space rather than leased it. Our analyses comparing the costs of increased government ownership to the alternative of continuing to lease equivalent space showed that GSA could realize significant savings by increasing the proportion of federally-owned space.

We found that constructing 43 buildings GSA identified as potential new construction candidates between fiscal years 1991 and 1995 would save $12 billion over 30 years when compared to leasing equivalent space--a "present value" savings of about $1.3 billion in 1989 dollars.

Because of the Fund's inability to generate sufficient revenue for construction and the inherent budgeting bias against capital investment, GSA has been forced to increase its reliance on costly leased space. Similarly, GSA has turned to costly alternative financing techniques to finance new construction. These techniques, a form of borrowing from the private sector, allow GSA to supplement limited Fund revenues.

The marginal costs of these techniques are considerable. For example, our December 1989 report showed that the "purchase-contract" techniques GSA used to finance the construction of 68 buildings in the early 1970s cost, in 1988 present value terms, $288 million more than comparable treasury financing. For the 10 new construction projects that we understand GSA is proposing to finance through lease-purchase, we estimate that the additional marginal financing costs will likely be $463 million over a 30-year period with a present value of $166 million. (This assumes that GSA will be successful in limiting private financing costs to 75 basis points above the Treasury rate.) While lease-purchase is preferable to leasing, it is unquestionably more costly than financing through Fund revenues, direct appropriations, or U.S. Treasury loans.

GAO RECOMMENDATIONS

Ideally, Congress should eliminate the current bias against federal ownership of office space by restructuring the current federal budget to include a capital component as we have recommended before. A capital budget would help correct the budget bias and still disclose the entire cost of acquiring assets. The basic idea would be to annualize the costs of capital acquisitions by spreading the costs in the budget over the useful lives of the asset. The annual amount would be shown in the operating part of the budget as an operating expense. This would put capital acquisition costs on a comparable basis with annual lease costs. A fuller description of this concept is contained in our August 1989 report Budget Issues: Restructuring the Federal Budget-The Capital Component (GAO/AFMD-89-52).

However, capital budgeting has to be considered as a long-range solution because there are conceptual and practical questions to be resolved before such a system could be implemented. Recognizing this, we recommended in our December 1989 report on federal ownership of office space, that GSA take a leadership role in demonstrating the benefits of capital budgeting by separating its Fund activities into the categories of operating expenses and capital investment. In response to our recommendation, GSA took that first step in its 1991 budget.

Regardless of this outcome, it is imperative, as emphasized in our November 1989 general management report, that GSA (1) refocus its facilities management role from one of operating public buildings to one of providing central management leadership, policy guidance, and oversight, and (2) improve the quantity, quality, and reliability of its supporting management information systems so that it can better determine the total costs to operate individual buildings and project future leasing requirements and associated costs. Only then can GSA implement a critically needed strategic planning process and be held accountable for its results. Once GSA institutionalizes such a process, a governmentwide capital investment strategy can then be developed to (1) cost-effectively increase the ratio of government-owned space, (2) safeguard valuable public building assets, (3) bring about needed improvements in the quality of the workplace, and (4) provide a framework to promote better congressional oversight and decision-making.

As part of its overall operating philosophy, GSA will need to develop more of a customer-oriented focus and forge strong partnerships with tenant agencies. This way, GSA's planning can better take into account strategic considerations, such as workforce location and emerging technological trends, that not only affect office space needs but agencies' mission effectiveness as well.

GSA has made some progress toward this goal. In response to our general management and space ownership reports, GSA has recently established broad goals and objectives for its Public Buildings Service which it believes will provide clear direction, a framework for action, and a guideline for operations. We will evaluate the adequacy of GSA's new strategic planning efforts as part of our ongoing general management report follow-up.

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That concludes my prepared statement, Mr. Chairman. My colleagues and I would be pleased to respond to any questions.