United States General Accounting Office

GAO

Testimony

Before the Committee on Public Works and Transportation
Subcommittee on Public Buildings and Grounds
House of Representatives

Release on Delivery
Expected at
8:30 a.m. EDT
Thursday
October 28, 1993

PUBLIC BUILDINGS

Budget Scorekeeping Prompts Difficult Decisions

Statement of L. Nye Stevens
Director of Planning and Reporting
General Government Division

GAO/T-AIMD-GGD-94-43

[illegible]

Mr. Chairman and Members of the Subcommittee:

We welcome this opportunity to discuss the budget implications of alternative ways of financing the acquisition of office space for federal employees. As you know, we have reported and testified many times in recent years to this Subcommittee, its Senate counterpart, and the General Services Administration's (GSA) oversight committees on the need for and long-term benefits of greater investment in federal office buildings. At the end of this statement is attached a listing of many of these testimonies and reports. I will not summarize them here because our dialogue with this Subcommittee indicates that it fully understands and supports the argument that greater investment in modern, safe, and technologically adaptable space for the federal workforce can pay dividends in efficiency and productivity. Your concern is with meeting this need.

Obstacles to Investment

Our work has shown the existence of a substantial number of obstacles to capital investment in federal real property. The design of the Federal Buildings Fund, in which agency contributions are unrelated to the costs of long-term federal asset replacement, is one such obstacle, as is the increasing proportion of the fund going to fund short-term lease obligations which, unlike most capital investment, cannot be deferred. Another has been periodic agency rent caps which have cost the Fund billions of dollars over the years, though efforts have been made to compensate for this shortfall in recent years. An extremely important obstacle, which we stressed in our December 1992 Transition Report on GSA[1], has been GSA's lack of a strategic asset management concept for its present and future real estate inventory. This would require GSA to develop a long-term capital investment plan comparing the relative cost-effectiveness of building construction, purchase, lease, lease-purchase, modernization and disposal so that decisionmakers can choose the options that offer the greatest return on investment. The lack of such a plan has forced GSA into a short-term, transaction-by-transaction focus on individual prospectus projects without any long-term context around which to form a policy consensus within the Administration and with Congress.

In our sustained discussions with GSA over these issues, one final obstacle has constantly reemerged as underlying many if not all of the others. This is the issue, which can also be found in each of our reports and testimonies, of resource constraints enforced by the budget scorekeeping rules that consistently drive GSA toward short-term leases even when ownership clearly offers superior short-term and long-term cost advantages.

---

[1] Transition Series: General Services Issues (GAO/OCG-93-28TR)

During the past decade and a half huge deficits have increased the pressures faced in the annual appropriations process. Indeed, it was such pressures that led to the short sighted policy I mentioned earlier of putting caps on agency rental payments. These pressures have made it difficult for Congress to pursue the most cost-effective way of acquiring buildings, which is through outright purchase. Overall budgetary caps, first agreed to in 1987, were later legislated in the Budget Enforcement Act (BEA). Partly in response to such pressures, GSA has turned more to leases as a way of meeting its most urgent needs.

Of course leases make sense when office space may be needed for a short or uncertain period of time. However, they are a costly alternative to ownership over the long run, particularly when the government requires special purpose facilities. In such cases, if outright purchase is not a realistic alternative, a long run lease with option to purchase would seem to be a desirable alternative from GSA's point of view. However, the scorekeeping rules that were enacted as part of the BEA require such arrangements to be treated as if they were purchases, effectively preventing GSA from taking advantage of this option.

In contrast, the rules for ordinary operating leases require only that the current year's lease costs be recognized because technically they do not commit the government to payments beyond a single year. Many such leases turn out to be more costly over the long run, however, because GSA typically (1) enters into multiyear leases to house permanent activities of government, (2) makes annual payments over the entire lease period, (3) either renews the lease or signs a new one, and (4) indirectly pays local property taxes which are not due on properties it owns.

In December 1989 we issued a report that demonstrated conclusively the economic short-sightedness of leasing to house permanent government functions.[2] It showed that on 43 proposed leases alone GSA could save $12 billion through ownership over 30 years (a then-present value of $1.3 billion). GSA readily agreed to our analysis, but pointed out that as a practical matter it was driven to recommending leasing to Congress because it lacked the up-front cash in the Federal Buildings Fund to finance the projects. Similar reasons were advanced for GSA's failure to follow up on our recommendation that purchases of existing buildings be undertaken again because of their cost-effectiveness,[3] and for GSA's desultory pursuit of bargain

---

[2]FEDERAL OFFICE SPACE: Increased Ownership Would Result in Significant Savings (GAO/GGD-90-11).

[3]BUILDING PURCHASES: GSA's Program Is Successful But Better Policies and Procedures Are Needed (GAO/GGD-90-5), October, 1989.

office properties in the hands of the Resolution Trust Corporation.[4] The impracticality of the construction, purchase, and lease-purchase options also serves as a deterrent to GSA adopting our recommendations to improve its long-term strategic planning process.

Solution to Scorekeeping Obstacle is Not Easy

Although the budget scoring rules are often cited as an obstacle to more cost effective asset acquisition, it does not necessarily follow that changing the rules to promote lease-purchases is the appropriate countermeasure. The scoring rules were instituted to advance broader objectives involving fiscal responsibility and protecting the budget against the temptations of proposals offering short-term programmatic benefits involving longer term costs. Changes to these rules should be undertaken only after considering the specific impact on asset acquisition decisions as well as the broader implications for spending control and deficit reduction.

With regard to asset acquisition, ideally budget scorekeeping should be neutral and permit GSA to evaluate ownership or leasing options based on their relative cost effectiveness, not their relative effect on budget scorekeeping. The 1990 rules requiring up-front scoring of budget authority and outlays for lease-purchases went at least part of the way to securing a neutral playing field. It is sometimes overlooked that our 1989 report on building ownership pointed out that lease-purchase contracts (assuming private financing) are a more costly method of acquiring government office space than government-financed purchases. Before 1990, scoring rules provided an incentive in favor of the more expensive lease-purchase option because they permitted spreading budget authority and outlays over the period of the lease and hid the true cost of the acquisitions.

The new scoring is appropriate because lease-purchases are, in effect, outright purchases. The only difference is that purchases are financed through Treasury borrowing while lease-purchases are financed through the private sector which makes them more expensive. Thus, Congress should make the same up front consideration of lease-purchase costs as it does with purchases, lest it unduly favor the more expensive lease-purchase option.

Moreover, lease purchases are a form of loan guarantee, and under credit reform, which was passed as part of the Budget Enforcement Act, guarantees are scored in terms of current economic costs.

---

[4]FEDERAL OFFICE SPACE: Obstacles to Purchasing Commercial Properties from RTC, FDIC, and Others (GAO/GGD-92-60), March 1992.

The financing for a new building under a lease purchase agreement crowds out private sector borrowing and uses up private saving just as surely as Treasury Department borrowing. If lease purchase arrangements were permitted favorable treatment it would be extremely difficult to limit their use, since modern financial markets can transform virtually any long term government contract or obligation into some type of security.

Although the up-front scoring of lease-purchases corrected one kind of bias, it introduced another bias toward operating leases. Assuming continuous government occupancy of space, these are more costly in the long run but are made to appear cheaper by recording their costs annually rather than up-front in the budget. We agree that this discrepancy distorts decisions and breaches the principle of neutrality mentioned earlier. The key question is how to resolve it in a manner that doesn't cause more problems than it solves.

One solution to this distortion is to resurrect the pre-1990 scoring of lease-purchases. It is argued that this will permit the government to take advantage of an acquisition option that is cheaper over the long run than operating leases. In an environment where nearly all discretionary spending is limited by strict budget caps on both budget authority and outlays, it is undoubtedly the case that upfront scoring can have a chilling effect on both lease-purchases and purchases. It is also true that liberalizing the scoring rules for lease-purchases will probably prompt greater use of this instrument to acquire space.

But it can also have other consequences both for building acquisition and for our system of budgetary controls which cause concern:

-- It would once again distort purchasing decisions by making a more expensive option--lease purchases--appear cheaper than a less expensive option--outright purchases.

-- It would weaken scrutiny of lease-purchase proposals by permitting Congress to essentially back in to their funding one year at a time, and to offload the greatest portion of costs on future Congresses. Requiring full up-front cost recognition provides the strongest incentives for both the Administration and Congress to think carefully about decisions committing the government to space 30 years into the future.

-- Once choices are made to appear cheaper than they really are, there is a strong likelihood that long-term spending will be higher as a result. Although lease purchases could reduce federal costs when supplanting more costly operating leases, changing their scoring might encourage their use in other situations not warranted by a comparison of a project's benefits with its full life cycle costs. Should increased outlays for buildings result over time, some other program or programs will suffer in a budgetary environment controlled by caps.

-- It could become a precedent that might well lead to a serious gap in our system of budget control. If public buildings can gain exceptions from rules requiring upfront scoring, why not other federal programs that can also justify their costs by some future rate of return or stream of benefits? For example, a study on the Women, Infants, and Children (WIC) program suggests that almost 90 percent of its annual outlays are offset by savings to the federal government in the first year after birth. Some have advocated depreciating federal infrastructure programs in the budget as a way to recognize these programs' future benefits to the economy and to reduce the comparable bias against these kinds of programs in the budget. The point is not that these kinds of programs don't warrant increased budgetary attention or funding--on the contrary. Elsewhere, we have argued that federal investment programs that improve economic productivity should be highlighted in the budget presentation and in congressional budget resolutions.[5] But, changing the measurement of their costs in the budget understates the full costs of programs when budgetary decisions are made and will assuredly increase federal outlays for them, implicitly or explicitly reducing spending for other programs. Our system of budgetary caps has fostered many frustrated claimants for scarce federal resources; changing the rules for one set of claims threatens to unravel the entire system of budgetary controls.

In view of these concerns, we would suggest consideration be given to revisiting the scoring of operating leases. In principle, those leases that are perceived by all sides as long-term federal commitments ought to be scored in a way that is comparable to direct federal ownership. Applying the principle of full recognition of the long-term costs to all instruments is more likely to promote the emergence of the most cost effective alternative.

Conclusion

Mr. Chairman, resolution of this problem is not easy because it involves making choices--either implicitly or explicitly--among competing priorities for very limited federal budgetary

[5]Transition Series: Investment GAO/GGD-93-2TR, December 1992.

resources. Legitimate space acquisition needs of the government are at stake. But that's not all that is at stake. As long as total discretionary spending is controlled by tight caps, greater spending on public buildings will necessarily be accompanied by reduced spending on other programs in the budget. The decision about whether to increase funding for public buildings at the expense of other programs is properly a political decision for Congress to make. Current scoring rules require GSA to mount an effective argument justifying provision of full funding for purchase options--a difficult argument to make in the current budgetary environment, but one faced by all spending programs today.

-- -- -- --

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

RELATED GAO PRODUCTS

Federal Real Property: Key Acquisition and Management Obstacles (GAO/T-GGD-93-42, July 27, 1993).

Environmental Protection Agency: Plans in Limbo for Consolidated Headquarters Space (GAO/GGD-93-84, April 19, 1993).

Federal Buildings Fund Limitations (GAO/GGD-93-34R, April 5, 1993).

Transition Series: General Services Issues (GAO/OCG-93-28TR, Dec. 1992).

Federal Office Space: Obstacles to Purchasing Commercial Properties From RTC, FDIC, and Others (GAO/GGD-92-60, Mar. 31, 1992).

Real Property Management Issues Facing GSA and Congress (GAO/T-GGD-92-4, Oct. 30, 1991).

GSA: A Central Management Agency Needing Comprehensive Congressional Oversight (GAO/T-GGD-92-3, Oct. 29, 1991).

Long-Term Neglect of Federal Building Needs (GAO/T-GGD-91-64, Aug. 1, 1991).

Federal Buildings: Actions Needed to Prevent Further Deterioration and Obsolescence (GAO/GGD-91-57, May 13, 1991).

Facilities Location Policy: GSA Should Propose a More Consistent and Businesslike Approach (GAO/GGD-90-109, Sept. 28, 1990).

The Disinvestment in Federal Office Space (GAO/T-GGD-90-24, Mar. 20, 1990).

Federal Office Space: Increased Ownership Would Result in Significant Savings (GAO/GGD-90-11, Dec. 22, 1989).

Building Purchases: GSA's Program Is Successful But Better Policies and Procedures Are Needed (GAO/GGD-90-5, Oct. 31, 1989).

Public Buildings: Own or Lease? (GAO/T-GGD-89-42, Sept. 26, 1989).

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066.

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100