United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Legislation and National Security
Committee on Government Operations
House of Representatives

For Release on Delivery
Expected at
10 a.m.,
Tuesday
September 20, 1994

BUDGET ISSUES

Budget Scorekeeping for Acquisition of Federal Buildings

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GAO/T-AIMD-94-189

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss H.R. 2680 which proposes changing the current budget scorekeeping rules for the acquisition of federal buildings. We share your interest in ensuring that budget scorekeeping rules do not themselves create unintended incentives for choosing one spending option for office space acquisition over another, particularly if this option is more costly over the long-term. The Budget Enforcement Act of 1990 (BEA) discretionary spending caps are constraining the operating funds of the federal government; we need to use them wisely.

I will discuss the conceptual basis for the current scorekeeping rules and options for changing the way the government finances the acquisition of public buildings. Changes to scorekeeping rules should be considered, not only in terms of their potential impact on the General Services Administration's (GSA) acquisition decisions, but also in terms of their effect on our broader system of budgetary controls.

Conceptual Basis for Scorekeeping

I would like to begin by briefly describing the budget concepts and the reasons behind budget scorekeeping rules. To efficiently allocate resources, the Congress needs to know and vote on the full cost of any program it approves at the time a funding decision is made. Thus, budget scorekeeping rules require that budget authority for the cost of purchasing an asset - whether it be outright federal purchase or lease-purchase - be recorded in the budget when it can be controlled, that is, up front so that decisionmakers have the information needed and an incentive to take the full cost of their decisions into account.

The federal borrowing aspects of budget decisions are defined by the cash-based deficit. As a result, outlays are generally scored on a cash basis when they occur. Caps on budget authority control the long-term deficit while caps on outlays were established to control the near-term/annual deficits.

The discretionary caps, which allow little or no growth in nominal dollar spending, will become increasingly binding over the next several years. It is tempting, under these conditions, to defer capital acquisitions or to spread the costs out over time to create more room in the short term for what may be considered to be pressing, immediate needs. This temptation is not new--it predates the spending caps. In his January 1968 budget message, President Johnson requested no funds for the construction of federal buildings and deferred $143 million of previously funded construction to ease inflationary pressures. Shortly thereafter, in lieu of purchasing, the government leased several large newly constructed buildings for long-term occupancy purposes. It still leases several of them--and nearly half the space occupied by federal workers--today.

Just as scorekeeping should not artificially bias spending decisions, it should not provide misleading information about the long-term impact of those decisions. It is important to look at how any scorekeeping change will affect both immediate choices and the long-term deficit. Although the 1993 Omnibus Budget Reconciliation Act and an improving economy have helped reduce the deficit for the near term, the Congressional Budget Office has projected rising deficits over the longer term. Failure to recognize outyear cost commitments may simply push part of the deficit problem into the future. The full up-front recognition of outyear cost commitments entered into today will help ensure that the government takes into account both its short- and long-term fiscal interests.

Scoring Lease-Purchases

GSA has several options for satisfying long-term office space requirements. In the simplest terms, it can (1) purchase a building, either existing or constructed to specifications, (2) enter into a lease-purchase contract, or (3) use short- or long-term operating leases. Ideally, GSA's choice should not be influenced by budget scorekeeping rules. Budget scorekeeping should be neutral, permitting GSA to evaluate ownership or leasing options on their relative cost effectiveness.

Requiring up-front scoring of budget authority and outlays for lease-purchases partially levels the playing field. The only difference between lease-purchases and outright purchases is that outright purchases are financed through lower interest rate Treasury borrowing, while lease-purchases are financed through private sector borrowing, which makes them more expensive. Our 1989 report on building ownership pointed out that lease-purchase contracts are a more costly method of acquiring government office space than government-financed purchases.[1] Before fiscal year 1991, the scoring rules favored the more expensive lease-purchase option because they permitted spreading budget authority and outlays over the period of

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

the lease, thus not forcing consideration of total acquisition costs. Scoring full costs up-front permits the Congress to compare a lease-purchase with an outright purchase. The 1990 rules serve the Congress well by eliminating the artificial advantage previously given to lease-purchases.

One of the most important purposes of the budget is to regulate the impact of federal receipts and outlays on the economy in general and on the national credit markets in particular. The treatment of leases and lease-purchases should, to the extent possible, reflect the concern that large deficits reduce the amounts available for private investment. It is important to note, therefore, that lease-purchases and long-term operating leases are similar to loan guarantees in terms of their impact on national credit markets. This is because modern financial markets can transform virtually any long-term government contract or obligation, such as lease-purchases or long-term operating leases, into some type of security. Thus, the economic effects of lease-purchases and long-term operating leases are realized up-front when the developer obtains private financing backed by these federal commitments; up-front budgetary scoring reflects the timing of these economic events.

Problems in Financing Public Buildings

However, problems do exist with budgeting for public buildings. Up-front scoring of lease-purchases corrected one kind of bias, but it introduced pressures to use operating leases for which scoring rules require only that current year's budget authority and cash outlays be recognized in the budget.

Our ongoing work illustrates how this scoring rule biases budget choices. We are examining the building capital investment and leasing projects that GSA undertook in 4 of its 11 regions from 1990 through 1994 to determine if the most cost-effective decisions were being made. Our preliminary findings are that, while GSA routinely conducts benefit/cost analyses, in many cases it did not propose and, therefore, the Congress did not fund, the most cost-effective option identified in GSA's analyses. In these cases, GSA entered into operating leases to satisfy long-term space needs even though its analyses showed leases to be more costly than ownership.

GSA has become dependent on leasing to satisfy federal agencies' office space needs. In fiscal year 1994, GSA will spend over $2 billion on operating leases and projects that these costs will rise to $3 billion by 2002 unless the ratio of federally owned to leased space is increased.[2] Our work continues to show that the federal government could save billions of dollars in the long-term by owning office space instead of leasing it and by replacing old federally owned buildings instead of renovating them. However, our work also indicates that Federal Buildings Fund limitations and the scorekeeping rules, which favor operating leases, are among several major obstacles to cost-effective federal housing and asset management decisions.

Although annualized scoring may be appropriate for leases to meet short-term or temporary space needs, it does not appropriately account for the long-term commitments and costs at stake when leases are used for long-term space needs and accordingly favors leasing. The key question is how to resolve this bias in a manner that does not cause more problems than it resolves.

Solution to the Perceived Scorekeeping Obstacle Is Not Easy

One solution would be to resurrect the pre fiscal year 1991 scoring of lease-purchases as proposed in H.R. 2680. 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 up-front scoring can have a chilling effect on both lease-purchases and outright purchases. It is also true that liberalizing the scoring rules for lease-purchases will probably prompt greater use of this option to acquire space.

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

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

-- Scrutiny of lease-purchase proposals would be weakened by permitting the executive branch to budget for and the Congress to fund major long-term commitments 1 year at a time. This offloads the greatest portion of costs on future Congresses. Requiring full up-front cost recognition of the resource commitment provides

[2]Currently 52 percent of federal office space is owned and 48 percent leased.

the strongest incentives for both the Administration and Congress to think carefully about decisions that, for example, commit 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 increase as a result.

-- Special treatment for public buildings will give them an advantage over other investments that promote economic growth, such as highways or research and development programs. Spending for these other kinds of investments is typically not permitted to be spread over a period of time; it is recognized up-front. For example, we do not budget for the depreciated cost of highways or weapon systems over the useful lives of those assets. If public buildings can be exempted from rules requiring up-front scoring, other federal programs that can also justify their costs by some future rate of return or stream of benefits could claim the same treatment.

<u>Other Alternatives</u>

In light of the deficiencies both in the current process which favors leasing and in the proposal to favor lease-purchases, it is important to consider other alternatives to deal with the problems of financing public buildings and also to recognize that it is difficult, if not impossible, to devise a perfect solution. In a resource constrained environment in which all needs cannot be financed, program proponents tend to seek out any budgetary advantage that can be found. Thus, scoring changes may have unintended and unanticipated effects and must be carefully considered.

One option for scorekeeping that could be considered would be to recognize that many operating leases are used for long-term needs and should be treated on the same basis as purchases. This would entail scoring up-front the present value of lease payments covering the same time period used to analyze ownership options. This would make such instruments comparable in the budget to direct federal ownership. Applying the principle of up-front full recognition of the long-term costs to all options for satisfying long-term space needs--purchases, lease-purchases, or operating leases--is more likely to result in selecting the most cost effective alternative than the current scoring rules. Further, such an approach would be consistent with the long-term present value costing required to be used under OMB Circular A-94 for benefit-cost analyses for these projects.

As with any approach, this option poses its own problems. It will be difficult to reach agreement on what constitutes long-term space needs that would warrant this up-front budgetary treatment; the agencies and GSA would have to sort out space needs based on a determination of whether long- or short-term needs are involved. Further, we would be making judgments on what constitutes a long-term need based on projections about the future and not on the government's legal commitment.

There would also be some implementation challenges. If operating leases were scored up-front, adjustments to the BEA caps would be necessary to accommodate the scoring change. For existing leases, additional budget authority would need to be provided and the caps would have to be adjusted upward initially to reflect the higher up-front costs. The caps would be lowered in succeeding years to recognize the lower annualized costs.

Such a change would need to be phased in because of resource constraints, based on GSA's identification of a large number of existing leases that ought to be changed to ownership. As part of its recently completed "Time Out and Review" of major approved new building construction, modernization, and leasing projects in response to the National Performance Review, GSA identified 19 major space requirements now satisfied by leased space where it believes that conversion to government ownership would save hundreds of millions of dollars. Moreover, improvements in acquisition planning and the funding of the Federal Buildings Fund, as discussed below, would also facilitate the transition to up-front scoring of long-term operating leases.

Another alternative which has been offered by OMB to address problems in financing public buildings without changing existing scoring rules would be to use the excess budget authority currently available under the discretionary budget caps. Action on current appropriations legislation is beneath the estimated end-of-session discretionary caps. This excess of allowable budget authority could be appropriated to finance buildings. However, outlays would have to be stretched out to stay within the outlay caps. Under current scoring rules, outlays can only be stretched out over the period of building construction, not for purchases of existing buildings.

Regardless of how the scoring issues are resolved, we stressed in our December 1992 transition series report on

GSA[3] that GSA needs a strategic asset management concept for its present and future real estate portfolio. GSA does not have a long-term capital investment plan that compares the relative cost-effectiveness of building construction, purchase, lease, lease-purchase, modernization, and disposal. Such a plan would allow decision-makers to choose the options that offer the greatest return on investment. Without this plan, GSA, as well as the Congress, have been forced into a short-term, transaction-by-transaction focus on individual prospectus projects. GSA has not had any long-term context around which to form a policy consensus within the Administration and with the Congress.

The National Performance Review recognized the need for better asset planning. In its report on improving financial management, it recommended that a long-term fixed asset planning and analysis process be established and that fixed asset long-term planning be incorporated in the federal budget process. In response, OMB recently issued Bulletin No. 94-08, "Planning and Budgeting for the Acquisition of Fixed Assets."

OMB stated that if the federal government is to plan and budget more effectively for asset acquisitions, agency planning and budgeting processes, as well as OMB review, must be improved. OMB also stated that the decision-making process for the acquisition of fixed assets should recognize the implications of a shrinking federal workforce and the consequences of organizational streamlining that are underway in virtually all areas of government.

OMB plans to give special attention to fixed assets during the fiscal year 1996 budget decision-making process. OMB is calling for agencies to develop 5-year plans for the acquisition of fixed assets. In developing these plans, OMB directed the agencies to consistently apply existing scoring rules, in particular full up-front costs for lease-purchases.

The OMB bulletin also referred to greater use of flexible funding mechanisms to promote public building investments. One of the funding mechanisms OMB identified is a revolving fund. The Federal Buildings Fund is a revolving fund, but it operates under constraints that have inhibited cost-effective investments. The Fund does not generate sufficient revenue for needed construction and acquisition because rent charged to agencies does not reflect GSA's full costs of doing business. Moreover, the Fund is not

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

permitted to retain and use the proceeds of sales of unneeded public buildings to finance future acquisitions.

Conclusion

Mr. Chairman, resolution of this problem is not easy. It involves making choices--either implicitly or explicitly--among competing priorities for very limited federal budgetary resources. Legitimate space acquisition needs of the government are at stake, but that is not all. 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 that only the Congress can make.

The up-front scoring of long-term space acquisitions requires GSA to mount an effective case, based on a sound long-term asset acquisition plan, to justify its long-term space proposals. While such a case is difficult to make in the current budgetary environment, it is one faced by all spending programs today.

This concludes my prepared statement, Mr. Chairman. I would be pleased to respond to any questions you or the other members may have.

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