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General Government Division

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August 6, 1997

The Honorable James A. Traficant, Jr.  
Ranking Minority Member, Subcommittee  
on Public Buildings and Economic Development  
Committee on Transportation and Infrastructure  
House of Representatives

Subject: Space Acquisition Cost: Comparison of GSA Estimates for Three Alternatives

Dear Mr. Traficant:

This letter responds to your request that we provide you with information on the General Services Administration's (GSA) comparison of the estimated costs to acquire certain space using three alternatives—lease, direct federal construction, and lease-purchase.<sup>1</sup> Specifically, you asked that the comparison cover 10 large leases that were approved by Congress between 1992 and 1996. You requested this information because of your concern that the current budget environment makes it unlikely that GSA would be able to use the construction or lease-purchase option to add space to the federal inventory, even when these options could reduce the government's overall cost of space.

Our objective was to obtain and compare GSA's estimated costs for acquiring space using the three specified acquisition alternatives. We did not consider a fourth acquisition alternative, the purchase of existing commercial office buildings, because GSA staff said information was not readily available on whether commercial office buildings of appropriate size and configuration were available in the market. GSA used its computerized economic analysis model to develop the cost estimates for the selected real property acquisitions. We also discuss some implications that budget scorekeeping has on real property acquisition. Although we did not validate the economic model used to do the analyses or the results of the analyses, we verified selected data that GSA used in its analyses.

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<sup>1</sup>Lease-purchase is an agreement between a lessor and lessee in which the lessee agrees to lease a building for a specified length of time and then takes title to the building at the end of the lease period.

## BACKGROUND

As the federal government's landlord, GSA provides office space for most federal agencies. GSA leases about 130 million square feet and owns about 270 million square feet of space throughout the nation. Part of its responsibility is to work with agencies to identify space needs that cannot be met with the existing inventory and recommend the most appropriate way of acquiring the needed space. Under this responsibility, it is required to prepare project descriptions, called prospectuses, for space acquisitions that are expected to exceed specified dollar thresholds.<sup>2</sup> The prospectuses are to include (1) information on the size and location of the proposed acquisition, (2) a justification for it, and (3) economic analyses of acquisition alternatives. These economic analyses, which are present value cost analyses, are to identify costs that would accrue while the government occupies the space; use appropriate discount rates to adjust these costs so that their value is expressed in terms of a common year; and use these discounted values to calculate a cost for each alternative. These prospectuses must be approved by the Office of Management and Budget, the Senate Committee on Environment and Public Works, and the House Committee on Transportation and Infrastructure before GSA can acquire the space.

Our December 1989 report<sup>3</sup> discussed GSA's efforts to add space to the federal inventory. It stated that the federal government could realize significant savings if it owned some of the space it leased. Specifically, the report noted that ownership would have been a less costly and thus a preferred alternative for acquiring space for 16 of 72 major lease proposals submitted to Congress in 1988, but that GSA was forced to choose leasing in these cases because it lacked sufficient funds for construction. The report also pointed out that ownership through lease-purchase costs more than direct construction or the purchase of an existing building because the government generally pays higher interest rates to finance a lease-purchase project. In an earlier report,<sup>4</sup> we said that GSA's acquisition costs were generally lower for commercial buildings it had purchased in the past. Specifically, we said that the purchase prices for 7 of the 10 office buildings that GSA had purchased were below their appraised values and that total acquisition costs, which included construction costs needed to prepare them for occupancy, were less than what GSA believed it would have paid to construct or lease equivalent space.

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<sup>2</sup>The threshold was \$1.525 million in fiscal year 1992 and increased each year until it reached \$1.68 million in fiscal year 1996.

<sup>3</sup>Federal Office Space: Increased Ownership Would Result in Significant Savings (GAO/GGD-90-11, Dec. 22, 1989).

<sup>4</sup>Building Purchases: GSA's Program is Successful but Better Policies and Procedures Are Needed (GAO/GGD-90-05, Oct. 31, 1989).

RESULTS

Our comparison of GSA's space acquisition cost estimates, which yielded results that were consistent with our earlier report, showed that, for 6 of the 10 proposed acquisitions that were analyzed, government ownership by construction or lease-purchase would have a cost advantage over leasing. In a comparison of the ownership alternatives, construction always had a cost advantage over lease-purchase. Table 1 shows the estimated cost to acquire space using each of the three alternatives and the cost advantage or disadvantage of the lease-purchase and construction alternatives relative to that of leasing.

Table 1: Present Value of Estimated Cost for Three Acquisition Alternatives and Their Comparative Cost Advantages and Disadvantages

Square feet in thousands; dollars in millions

| Primary occupant(s) and location for acquisitions analyzed               | Total square feet | Base year for present value analysis <sup>a</sup> | Estimated present value acquisition cost for each selected alternative |                             |                           | Cost advantage/ (disadvantage) <sup>b</sup> |                        |
|--|-------------------|---|--|-----------------------------|---------------------------|---|------------------------|
|  |                   |   | Lease  | Ownership by lease-purchase | Ownership by construction | Lease-purchase vs. lease                    | Construction vs. lease |
| Patent and Trademark Office (PTO), Washington, D.C.                      | 1,989             | 1995  | \$972.8  | \$934.6                     | \$924.7                   | \$38.2                                      | \$48.1                 |
| Department of Agriculture, Kansas City metropolitan area, MO/KS          | 307               | 1995  | 148.6  | 122.3                       | 121.6                     | 26.3  | 27.0                   |
| Army Audit Agency (AAA) and Department of Agriculture, Northern Virginia | 183               | 1993  | 90.9   | 77.9                        | 76.3                      | 13.0  | 14.6                   |
| Federal Energy Regulatory Commission (FERC), Washington, D.C.            | 398               | 1991  | 193.2  | 184.5                       | 181.5                     | 8.7   | 11.7                   |
| Internal Revenue Service (IRS), Fresno, CA                               | 184               | 1994  | 80.5   | 72.8                        | 70.9                      | 7.7   | 9.6                    |

| Primary occupant(s) and location for acquisitions analyzed                                | Total square feet | Base year for present value analysis <sup>a</sup> | Estimated present value acquisition cost for each selected alternative |                             |                           | Cost advantage/ (disadvantage) <sup>b</sup> |                        |
|---|-------------------|---|--|-----------------------------|---------------------------|---|------------------------|
|   |                   |   | Lease  | Ownership by lease-purchase | Ownership by construction | Lease-purchase vs. lease                    | Construction vs. lease |
| Environmental Protection Agency (EPA), Kansas City metropolitan area, MO/KS               | 209               | 1994  | \$76.3   | \$70.3                      | \$68.6                    | \$6.0                                       | \$7.7                  |
| Library of Congress, suburban MD  | 214               | 1993  | 35.6   | 36.1                        | 35.8                      | (0.5)                                       | (0.2)                  |
| National Archives and Records Administration (NARA), Philadelphia, PA                     | 300               | 1991  | 54.1   | 55.7                        | 55.1                      | (1.6)                                       | (1.0)                  |
| Social Security Administration (SSA), Woodlawn, MD  | 706               | 1992  | 196.8  | 225.4                       | 222.0                     | (28.6)                                      | (25.2)                 |
| Communications and Electronics Command (CECOM), Department of the Army, Fort Monmouth, NJ | 640               | 1992  | 149.2  | 207.8                       | 202.4                     | (58.6)                                      | (53.2)                 |

<sup>a</sup>For purposes of this analysis, the base year for present value analysis is always 1 year before the prospectus submission date. Thus, a project with a base year for present value analysis of 1991 would have been requested for approval in fiscal year 1992.

<sup>b</sup>The estimated cost to acquire space is calculated on the basis of assumptions and economic conditions at the time the prospectus was prepared and submitted and may or may not reflect the actual cost of (1) the awarded lease or (2) a building constructed or lease-purchased when the lease was awarded.

Source: GSA analysis of 10 prospectus-level leases.

The GSA analyses in table 1 has four examples in which leasing was the more advantageous alternative. This result is consistent with our December 1989 report, which said leasing was a less costly alternative for 15 of 72 prospectuses examined. The narrative section of the approved prospectuses we examined provided an explanation for this in two of the four cases. For instance, in one case, the Communications and Electronics Command (CECOM) prospectus explained that leasing had a cost advantage because the government had negotiated renewal rates 20 years earlier that were extremely low and cost beneficial in relation to current construction rates. Also, the Library of Congress space was warehouse space, and the prospectus indicated that it was available at a low lease cost. However, in the other

two cases, neither the Social Security Administration (SSA) nor the National Archives and Records Administration (NARA) prospectus provided insights into why the analyses showed that the leasing alternative had a cost advantage. GSA officials could not recall the details of these prospectuses or the market conditions prevailing when the prospectuses were approved, so they could not determine why their analyses showed leasing had a lower present value cost. However, our December 1989 report said, and GSA officials agreed, that leasing can result in a lower estimated cost for a number of reasons, such as a favorable market resulting, for example, from a glut of available lease space.

Our December 1989 report, and the prospectuses we analyzed, also pointed out that for practical reasons leasing may, in some instances, be the preferred alternative. Our report said practical reasons for using leasing would be that no viable alternative to leasing existed because the housing need was temporary, flexibility was required to meet changing needs, or the geographic area had little federal activity. The prospectuses for the four activities for which GSA's analyses showed leasing with a lower present value also cited some practical reasons for leasing the space. For example, the prospectus for the SSA space cited anticipated changing needs; NARA's prospectus alluded to a temporary need; and CECOM's prospectus suggested that not renewing the lease would disrupt operations.

#### Effect of Budget Scorekeeping on Real Property Acquisitions

Decisions about which acquisition alternative to choose may be affected by budget scorekeeping rules.<sup>5</sup> Currently, the budget authority for the entire cost of acquiring an asset must be recorded up front—that is, recorded in the budget when the acquisition is approved—so that decisionmakers have the information needed to take the full cost of their decisions into account. Thus, the total budget authority for building construction, purchases, lease-purchases, and capital leases that commit the government to long-term obligations must be recognized and recorded in the year that the project is approved. In contrast, the rules for ordinary operating leases require only that the current year's lease costs be recognized and recorded in the budget. This makes the operating lease alternative appear to be less costly.

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<sup>5</sup>Appendix A, Scorekeeping Guidelines, and Appendix B, Scoring Lease-Purchase and Leases of Capital Assets, Office of Management and Budget (OMB) Circular A-11, dated June 23, 1997, reflect general budget scorekeeping conventions used by the House and Senate Budget Committees and OMB in measuring compliance with congressional budget targets and the Budget Enforcement Act of 1990, as amended. Among other things, the guidance provides instruction on the treatment of purchases, lease-purchases, and leases. It also requires that budget authority be scored in the year in which the authority is first made available in the amount of the government's total estimated legal obligations.

During testimony on budget issues before the Subcommittee on Legislation and National Security, House Committee on Government Operations, we stated that budget scorekeeping should be neutral among acquisition alternatives, permitting GSA and Congress to evaluate ownership—either by construction, purchase, or lease-purchase—or leasing options on their relative cost effectiveness.<sup>6</sup> We further stated that 1990 changes to the scorekeeping rules requiring lease-purchase costs to be recorded in the budget up front helped to put lease-purchase arrangements on a level playing field with the other ownership options and ensure accountability in decisions to commit future government resources.

In our testimony, we said that up-front scoring of lease-purchases helped correct the bias toward using this alternative to finance building projects. However, we pointed out that up-front scoring provided a greater incentive to use operating leases, because scoring rules require only that the current year's budget authority and cash outlays be recognized in the budget. We offered a possible remedy, which, in effect, would recognize that many operating leases are used for long-term needs and as such should be treated in the same manner as ownership options. This remedy would entail scoring up front the present value of lease payments covering the same period used to analyze ownership options, thereby making operating leases for long-term needs comparable in the budget to direct federal ownership. Applying the principle of up-front recognition of all long-term costs for all options for satisfying long-term space needs—construction, purchases of existing buildings, lease-purchases, or operating leases—is more likely to result in the most cost-effective alternative being selected than using the current scoring rules would.

As with any scoring approach, this one poses its own problems. If this scoring approach were adopted, it would be difficult to reach agreement in all cases on what constitutes the type of long-term space needs that would warrant this up-front budgetary treatment. The agencies and GSA would have to sort out space needs on the basis of a determination of whether long- or short-term needs are involved. Further, decisionmakers would be making judgments on what constitutes a long-term need based on projections about the future rather than on the government's legal commitment. Also, any existing budget caps would need to accommodate the scoring change. A greater amount of budget authority would be needed up front, but in the long term, budget authority and outlays should be lower since the scorekeeping incentives would promote choosing the most cost-effective alternative for acquiring long-term space.

#### SCOPE AND METHODOLOGY

To do our work, we contacted GSA officials responsible for developing cost estimates and had them select prospectus-level leases—2 for each year between 1992 and 1996. According to GSA officials, they selected these leases primarily by considering size

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<sup>6</sup>Budget Issues: Budget Scorekeeping for Acquisition of Federal Buildings (GAO/T-AIMD-94-189, Sept. 20, 1994).

(largest in square footage), as we had requested. When GSA did not include the largest leases, we confirmed that there was an identifiable reason that the lease could not be included, such as GSA's inability to locate the files containing the input for the economic analyses. GSA officials agreed to do the economic analyses and cost comparisons for each acquisition in accordance with OMB Circular No. A-94, Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs, dated October 29, 1992, which establishes the methodology for GSA's economic analysis. The circular specifies that the comparison of project alternatives should be in present value terms.<sup>7</sup>

In doing the analysis for each of the 10 properties, GSA (1) reconstructed the present value analysis that compared the estimated cost to lease or construct the space at the time the acquisitions were approved, and (2) performed a comparable present value analysis for the lease purchase alternative. GSA officials emphasized that there is a reasonable range of assumptions and other inputs that can be used in any analysis and that the specific results of the analysis depend on which figure in the range is used. Consequently, they cautioned that, when reviewing the results of their analyses, it should be kept in mind that using other assumptions and inputs could yield different results. The enclosure provides some of the input values that GSA used in its analyses.

Although we did not validate the economic model that GSA used to do the analyses or the results of the analyses, we verified selected data that GSA used in its analyses. First, we spot-checked some data entered into GSA's analysis to ensure that they were either consistent with those that were standard for each year's analyses or that GSA had used them in the original prospectus. Specifically, we did this for the general inflation rate, discount rate, major repair and alteration cost factor, the leased and owned management cost factor, and the tenant alteration factor. We did not advise GSA staff of the data elements that were going to be checked before they did their analyses. Second, we confirmed that the estimated present value costs for construction and lease developed for our analyses were in line with those included in the original prospectus. Finally, we reviewed the leases that GSA selected for analyses to ensure that they conformed with the established size selection criterion or to identify why any large leases were not included.

Our discussion about the implications of budget scorekeeping rules on the acquisition of real property was based on a review of our past position, which was presented in our September 1994 testimony.<sup>8</sup>

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<sup>7</sup>Present value cost analysis is also applicable to other types of real property acquisition, such as the purchase of existing buildings. We did not ask GSA to perform present value cost analyses for other acquisition alternatives, because such analyses were beyond the scope of this request.

<sup>8</sup>GAO/T-AIMD-94-189.

The results of this work cannot be generalized to the universe of leases for the selected years or for any other years. We did our analyses between February and June of 1997. On July 15, 1997, we requested oral comments on a draft of this letter from the Administrator, GSA.

#### AGENCY COMMENTS

On July 21, 1997, GSA's Public Buildings Service's management officials, and the realty specialists who developed the cost estimates and analyses presented in this letter, provided GSA's oral comments. With the exception of the points discussed below, GSA generally agreed with the information presented in this letter.

Our draft letter included a GSA analysis showing that if GSA had used a slightly lower interest rate in its economic analysis, then lease-purchase would have been a less costly alternative than direct construction. In commenting on the draft, GSA officials said that, although they provided these data and analysis, after further review they recognized that, when using the lower interest rate, they should have changed the value of the management cost factor used in the analyses on the basis of their past experience. Using the adjusted value, in their view, would have changed the results of the analyses and made construction a less costly alternative than lease-purchase. GSA officials requested that we delete the analyses from the final letter, which we did.

GSA officials also noted that our suggestion that operating leases used for long-term space be scored up front to make them comparable with direct federal ownership would require a lot of judgment to implement. Rather than making judgments about what constitutes a long-term need, the GSA officials believed it would be better to score all operating leases up front, regardless of the term of the lease. The officials also told us that GSA no longer includes clauses in its leases permitting the government to terminate them at its convenience because such clauses unnecessarily drove lease costs up. Thus, according to the officials, GSA is committing the government for the term of the lease when it is signed. They believe that this further supports scoring all operating leases up front.

We agree with the GSA officials that implementation of our suggestion would require judgments to be made and agreements to be reached on what constitutes a long-term space need. This letter makes that point. However, we believe that there may be legitimate short-term space needs that warrant being scored differently than long-term needs. GSA's proposal may have merit. However, the proposal also could have possible unanticipated effects on satisfying short-term space needs and budget incentives. The scope of our work did not include an evaluation of the possible effects.



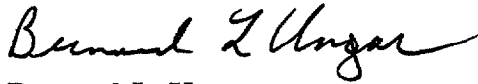
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GSA also provided several technical comments, which we incorporated into this letter where appropriate.

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We are sending copies of this letter to the Chairman of your Subcommittee; the Chairmen and Ranking Minority Members of Committees that have jurisdiction over GSA; the Director, Office of Management and Budget; and the Administrator of GSA. Copies will be made available to others on request. The major contributors to this letter were Gerald Stankosky and Christine Bonham, Assistant Directors; and John Mortin and Bill Dowdal, Senior Evaluators. If you have any questions, please contact me on (202) 512-4232.

Sincerely yours,



Bernard L. Ungar  
Director, Government Business  
Operations Issues

**INPUT VARIABLES USED IN GSA'S ECONOMIC COST ANALYSES**

The following are some of the economic data that were used to develop the 10 selected prospectuses that were approved from 1992 to 1996.

|  | Planning year                  |        |        |        |        |
|--|--------------------------------|--------|--------|--------|--------|
|  | 1992                           | 1993   | 1994   | 1995   | 1996   |
|  | Year for present value dollars |        |        |        |        |
| Economic data                                  | 1991                           | 1992   | 1993   | 1994   | 1995   |
| <b>Input variable: percentages</b>             |                                |        |        |        |        |
| General inflation rate                         | 4%                             | 4.5%   | 4%     | 3.1%   | 2.9%   |
| Discount rate                                  | 8                              | 8.5    | 7.9    | 7.1    | 6.8    |
| Assumed government guaranteed rate             | 8.75                           | 9.25   | 8.65   | 7.85   | 7.55   |
| <b>Input variable: dollars per square foot</b> |                                |        |        |        |        |
| Major repair and alteration cost               | \$2.12                         | \$2.12 | \$1.84 | \$1.85 | \$1.85 |
| GSA's leased management cost                   | 0.71                           | 0.97   | 1.09   | 1.16   | 1.10   |
| GSA's owned management cost                    | 0.97                           | 1.28   | 1.29   | 1.50   | 1.79   |
| Tenant alterations                             | 1.07                           | 1.11   | 1.34   | 1.31   | 1.67   |

Source: Dennis Eisen, Decision Making in Federal Real Estate (Rockville, Md.: Lakeside Publishers, 1997), p. 272; GSA; and GAO computation of interest rates based on GSA data.

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