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# REPORT TO THE SUBCOMMITTEE ON TREASURY, POST OFFICE, AND EXECUTIVE OFFICE COMMITTEE ON APPROPRIATIONS UNITED STATES SENATE



# Leasing Versus Buying Small And Medium Size Post Office Buildings

B-145650

## Post Office Department

*BY THE COMPTROLLER GENERAL OF THE UNITED STATES*

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MARCH 12, 1971

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Dear Mr. Chairman:

This is in response to the Committee's request of September 30, 1970, that we inform you of the results of our review of the Post Office Department's method of acquiring small and medium size post office buildings.

According to the Postmaster General's annual report for fiscal year 1969, at June 30, 1969, the Department was occupying about 141 million square feet of space in 30,378 buildings, including about 80 million square feet of interior space in 27,312 leased buildings. During fiscal year 1969, the Department awarded contracts for the lease of 971 new or remodeled buildings for small and medium size postal facilities containing about 5.3 million square feet of interior space. The Department estimated that the lessors' cost of constructing or remodeling these leased buildings amounted to about $88.2 million.

The Department usually acquired new space for small and medium size postal facilities under contracts with private industry for the lease of buildings to be constructed to the Department's specifications on sites either owned or controlled by the Department, pursuant to authority vested in the Postmaster General to lease space for postal facilities for periods not to exceed 30 years (39 U.S.C. 2102-2103). Before entering into a lease agreement, the Postmaster General was required by 39 U.S.C. 2103(a) to determine, after consultation with the Administrator of General Services, that it was not desirable or feasible to construct postal facilities for Government ownership under the Public Buildings Act of 1959, as amended (40 U.S.C. 601-615). The Administrator of General Services delegated to the Postmaster General the authority to construct postal facilities for Government ownership but required that the facilities be constructed to the design and construction standards of the General Services Administration.

The Department followed the general policy of formally advertising for proposals for lease-construction contracts. The contracts awarded for the lease of small and medium size post office buildings specified the annual lease costs and usually provided for the lease of the buildings for periods ranging from 10 to 20 years and for renewal of the leases at the option of the Department.

The Department generally leased small and medium size post office buildings without evaluating whether it would be more economical to construct the buildings. The Department stated that, although it was desirable to compare the cost of leasing post office buildings with the cost of constructing the buildings before reaching an investment decision, the requirement that such buildings be constructed to General Services Administration's design and construction standards and the nonavailability of construction funds made it impracticable to do so. The Department stated also that the lessors' cost of constructing the leased buildings was less than the Government's construction cost would have been because of the requirement that the buildings be constructed to the higher standards of the General Services Administration.

As previously indicated, the Department, at the time of leasing the small and medium size post office buildings, had not made estimates of what the Government's cost of constructing the buildings to General Services Administration's standards would be. Therefore data was not available that would have permitted us to determine whether it might have been economically advantageous for the Department to have constructed rather than lease the buildings.

The Postal Reorganization Act, Public Law 91-375, approved August 12, 1970 (84 Stat. 719), recodified title 39, United States Code, and created the United States Postal Service as an independent establishment in the executive branch of the Government. The act provides the Postal Service with broad real estate acquisition authority (39 U.S.C. 401, 410(a)) and borrowing authority (39 U.S.C. 2005). Since, under this broad real estate acquisition authority, facilities constructed by the Postal Service need not conform to General Services Administration's design and construction standards, it appears to us that the cost of constructing a postal facility to the Department's specifications should be about the same, irrespective of whether the service or a private party contracts for its construction.

In our opinion, the Postal Service should base a decision as to whether to construct or lease a postal facility on a comparison of the costs that would be incurred under both alternatives. The comparative costs could be determined under two methods: the accumulated interest method prescribed in Bureau of the Budget Circular No. A-76, Revised, dated August 30, 1967, and the present value method. Under the first method, the total annual costs to lease a facility are compared with the cost of owning the facility for the period of the lease; that is, the total of the investment costs, the annual imputed interest on the unamortized investment costs, and the annual operating expenses, less the balance of the unamortized investment (residual value) in the facility. Under the second method, the present value of the annual payments for the lease of a facility is compared with the present value of the cost of owning the facility for the period of the lease; that is, the investment costs and the present value of the annual operating expenses, less the present value of the unamortized investment costs (residual value) in the facility.

The desirability of making comparisons of the cost of leasing or owning a facility is illustrated in the case of the Department's lease of a postal facility for a 10-year period for $182,260; the Department estimated that the lessor had constructed the building at a cost of $162,919. The following tables, based on the assumption that the Department's cost of constructing the facility would have been the same as the lessor's cost, show that, under both computation methods, it would have been more economical, at certain interest rates, for the Department to have constructed the facility.

## Accumulated Interest Method

| | Leasing costs | Ownership costs | Difference |
|---|---|---|---|
| At 5 percent interest rate: | | | |
| Lease payments | $182,260 | $ - | |
| Land cost | - | 7,500 | |
| Building cost | - | 162,919 | |
| Imputed interest | - | 76,045 | |
| Residual value (building and land) | - | -129,689 | |
| Operating expenses | - | 43,930 | |
| Total | $182,260 | $160,705 | $21,555 |
| At 6 percent interest rate: | | | |
| Lease payments | $182,260 | $ - | |
| Land cost | - | 7,500 | |
| Building cost | - | 162,919 | |
| Imputed interest | - | 91,254 | |
| Residual value (building and land) | - | -129,689 | |
| Operating expenses | - | 43,930 | |
| Total | $182,260 | $175,914 | $ 6,346 |
| At 8 percent interest rate: | | | |
| Lease payments | $182,260 | $ - | |
| Land cost | - | 7,500 | |
| Building cost | - | 162,919 | |
| Imputed interest | - | 121,672 | |
| Residual value (building and land) | - | -129,689 | |
| Operating expenses | - | 43,930 | |
| Total | $182,260 | $206,332 | -$24,072 |

As indicated in the above table, at interest rates up to about 6.5 percent, it would be more economical to own the facility and at higher interest rates, it would be more economical to lease the facility.

Present Value Method

| | Leasing costs | | Ownership costs | | |
|---|---|---|---|---|---|
| | Total | Present value | Total | Present value | Difference |
| At 5 percent discount rate: | | | | | |
| Lease payments | $182,260 | $143,196 | $ - | $ - | |
| Land cost | - | - | 7,500 | 7,500 | |
| Building cost | - | - | 162,919 | 162,919 | |
| Operating expenses | - | - | 43,930 | 34,514 | |
| Residual value (building and land) | - | - | 129,689 | -78,742 | |
| Total | $ - | $143,196 | $ - | $126,191 | $17,005 |
| At 6 percent discount rate: | | | | | |
| Lease payments | $182,260 | $136,810 | $ - | $ - | |
| Land cost | - | - | 7,500 | 7,500 | |
| Building cost | - | - | 162,919 | 162,919 | |
| Operating expenses | - | - | 43,930 | 32,975 | |
| Residual value (building and land) | - | - | 129,689 | -71,280 | |
| Total | $ - | $136,810 | $ - | $132,114 | $ 4,696 |
| At 8 percent discount rate: | | | | | |
| Lease payments | $182,260 | $125,184 | $ - | $ - | |
| Land cost | - | - | 7,500 | 7,500 | |
| Building cost | - | - | 162,919 | 162,919 | |
| Operating expenses | - | - | 43,930 | 30,173 | |
| Residual value (building and land) | - | - | 129,689 | -58,428 | |
| Total | $ - | $125,184 | $ - | $142,164 | -$16,980 |

The above table shows that, at a discount rate of 5 percent, it would be more economical to own the facility which may have many years of useful life beyond the lease period. At a discount rate approaching 7 percent, however, the lease of the facility would be more economical.

The Department awarded a contract to an information systems company for a study of the methodology for choosing between lease and buy alternatives in the acquisition of postal space. In October 1970, the Department received the company's report which pointed out the multiplicity of factors that should be considered in lease/buy decisions and which concluded that every situation should be examined individually on the basis of economic analyses. The Department is currently evaluating the study report.

We believe that, in view of the large number of small and medium size post office buildings that are leased annually, the Postal Service should base its decisions as to whether to construct or lease the buildings on comparisons of the costs that would be incurred under both alternatives.

The Department officials told us that, if the Department was not required to construct postal facilities to General Services Administration's design and construction standards, a decision as to whether to construct or lease a facility would be based on the evaluations made as suggested herein. Because the Postal Reorganization Act vests the Postal Service with broad real property acquisition authority it is now practicable for the Postal Service to make these evaluations. We believe that decisions made on that basis will result in a better managed facility acquisition program.

We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of this report.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

The Honorable Joseph M. Montoya, Chairman
Subcommittee on Treasury,
Post Office, and Executive Office
Committee on Appropriations
United States Senate