

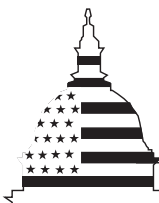
GAO

Chairmen and Ranking Minority
Members, House Committee on
Appropriations and House Committee
on Transportation and Infrastructure

August 2001

BUDGET SCORING

Budget Scoring Affects Some Lease Terms but Full Extent Is Uncertain



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United States General Accounting Office
Washington, DC 20548

August 31, 2001

The Honorable C.W. Bill Young
Chairman
The Honorable David Obey
Ranking Minority Member
Committee on Appropriations
House of Representatives

The Honorable Don Young
Chairman
The Honorable James L. Oberstar
Ranking Democratic Member
Committee on Transportation and Infrastructure
House of Representatives

This report responds to House Report 106-756, on the Treasury, Postal Service and General Government Appropriation Act, 2001, for a review of the effects that the current budget-scoring rules have had on the General Services Administration's (GSA) lease program.¹ The report expressed a concern that budget-scoring restrictions were forcing GSA to rely on shorter term leases that increase the costs to the Federal Buildings Fund because their per-square-foot costs are greater than longer term leases. This report said that this reliance on shorter term leases was hampering GSA's ability to fund other important programs such as repairs for maintaining the integrity of the federal building inventory and critically needed new construction.

As agreed with your offices, the objective of our work was to determine the impact of budget-scoring rules on the lease term and identify other factors that influence the lease term. We agreed to have GSA (1) identify whether all 39 prospectus-level lease projects, which GSA submitted to the appropriate House and Senate committees for fiscal year 2000 and 2001

¹Budget scorekeeping is the process of estimating the budgetary effects of pending and enacted legislation and comparing them with limits set in the budget resolution or legislation. Scorekeeping tracks data such as budget authority, receipts, outlays, the surplus or deficit, and the public debt limit.

were affected by budget scoring,² have GSA's 11 regional offices identify any other leases whose term was influenced by scoring, and review active lease files to see if we could determine the effects of budget scoring from the lease files; (2) determine, if possible, the monetary impact of budget scoring on the lease term; and (3) identify other factors that influence the lease term. Further, as agreed, we limited our review to only the budget scoring criteria that were concerned with the term of the lease. These criteria specify that in order for a lease to be scored as an operating lease, the lease term not exceed 75 percent of the estimated life of the asset and the present value of the minimum lease payments over the life of the lease not exceed 90 percent of the fair market value (FMV) of the asset at the beginning of the lease term.

During our review, we learned that the Security and Exchange Commission (SEC), which has independent leasing authority, entered into a lease for a new headquarters building that we identified as being affected by budget scoring. Other than the SEC lease, we did not review leases or lease projects of other agencies that use their own authority to lease space independent of GSA.

Results in Brief

The way in which budget-scoring rules were implemented affected the lease or lease project term of at least 13 federal agency leases.³ In addition to the SEC lease, which we identified, GSA regions identified 12 leases or lease projects whose terms were affected by budget-scoring rules.⁴ Additionally, other GSA leases or lease projects may have been affected by budget-scoring rules, but a number of factors hampered the identification of all such leases or lease projects. According to GSA officials, budget-scoring rules are affecting an unknown number of leases. For example, at the beginning of a lease acquisition, staff often assume or believe that a project will be affected by budget-scoring rules. Therefore, they reduce the lease term to one that they think will be scored as an operating lease versus a capital lease to avoid the higher up-front scoring associated with a capital lease. Further, when a lease is actually scored, the term may have

²A prospectus, which is a justification for a proposed project is required when its cost exceeds a legislatively established threshold and includes information on the project's size, cost, location, and other features; it is submitted to the appropriate House and Senate authorizing committees. All other leases are known as nonprospectus leases.

³A lease project is a project on which GSA is trying to obtain a lease.

⁴As of August 2000, GSA had more than 7,000 active leases.

to be reduced in order for it to be an operating lease. Also, as of October 1998, GSA's regional offices were to score and document the scoring of both prospectus- and nonprospectus-level leases, according to officials. However, the officials said that the files will contain only the final scoring sheets and not preliminary runs that might identify situations where a lease term was adjusted in order for the lease to score lower.

We could not determine the overall monetary impact of budget scoring on the lease term. GSA officials told us that they do not generally seek comparisons of long-term versus short-term leases in the solicitation process. However, we did identify three isolated cases that had comparisons of long term versus short-term leases in the solicitation process. Two were GSA leases that were not identified as being affected by scoring, and the SEC lease, which was affected by scoring. GSA had requested as part of the bidding process 10-year and 20-year lease costs, in one case, and 15-year and 20-year lease costs, in the other case. Our review of these two leases showed that for the winning offers, the long-term cost per net useable square foot (NUSF) was slightly lower than the shorter term offers cost per NUSF—3.24 percent, and 5.56 percent lower, respectively.⁵ Further, GSA also provided a consultant's report that showed the estimated annual lease costs per square foot for a Federal Bureau of Investigation (FBI) building in Texas were 32 percent less expensive for a 20-year lease than for a 10-year lease. While GSA officials agreed that a 20-year lease usually has lower annual cost than a 10- or 15-year lease, they could not estimate the potential amount saved by using a 20-year lease versus a 10- or 15-year lease.

SEC had requested as part of the bidding process that offers range between 10 and 20 years. Our review of SEC lease files showed that for the successful offer, the 20-year lease cost and the 15-year lease costs were the same per rentable square foot (RSF).⁶

GSA officials stated that (1) if GSA has a justifiable need for a 20-year lease, (2) the space requirement is large enough, and (3) it is located in an appropriate market, then, in most cases, GSA should build rather than

⁵Net useable square feet is the term used by the government to identify the square footage of space that can actually be used to house agency operations.

⁶Rentable square foot is a term used in the commercial real estate market that includes net useable square feet plus the tenants' proportional share of common building areas, such as rest rooms, exit stairways/fire corridors, and lobbies.

lease because construction is generally less expensive than a long-term lease. We have previously reported that for long-term needs, construction is less expensive than leasing. Also, we have previously reported that the budget scoring rules have the effect of favoring leasing and that 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 or construction.⁷ We recently initiated a broad governmentwide review of real property management and plan to address the effects of budget scoring on real property acquisition, as well as other actions, as one part of this effort.

According to GSA officials, while budget scoring affects the term of some leases, the term of most leases is determined by various factors, either individually or in combination, such as rental market condition, location, and the term desired by the agency.

We received written comments from both GSA and SEC. GSA basically agreed with our report and provided additional comments supporting the effect of budget scoring on leasing. SEC provided clarifying information, which has been included in the report.

Background

Budget-scorekeeping rules were developed by the executive and legislative branches in connection with the Budget Enforcement Act of 1990. These rules are to be used by the scorekeepers to assure compliance with budget laws.⁸ Their purpose is to ensure that the scorekeepers measure the effects of legislation consistent with scorekeeping conventions and specific legal requirements. The rules are reviewed annually and revised as necessary to achieve that purpose. Leases may be of two general types—operating and capital. The Office of Management and Budget (OMB) identifies six criteria that a lease must meet in order to be considered an operating lease rather than a capital lease.

- Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the government at or shortly after the end of the lease term.

⁷*Acquisition of Leased Space for the U. S. Patent and Trademark Office* (GAO-01-578R, June 5, 2001).

⁸The scorekeepers are the House and Senate Budget Committees, the Congressional Budget Office, and the Office of Management and Budget.

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- The lease does not contain a bargain-price purchase option.
 - The lease term does not exceed 75 percent of the estimated economic life of the asset.
 - The asset is a general purpose asset rather than being for a special purpose of the government and is not built to unique specifications of the government lessee.
 - There is a private sector market for the asset.
 - The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the FMV of the asset at the beginning of the lease term.

If a lease does not meet all six criteria above, it must be treated as a capital lease for budget-scoring purposes. For a capital lease, the net present value of the total cost of the lease is scored as budget authority in the year budget authority is first made available for the lease. For GSA operating leases, only the budget authority needed to cover the annual payment is required to be scored.⁹ As we previously reported, in general, capital facilities should be funded up front at the time the federal government enters into the commitment.¹⁰

In June 1991, GSA wrote to OMB generally describing the policies and procedures it would follow to ensure the proper implementation of the new budget scoring rules. These rules were incorporated in OMB Circular A-11. Appendix B of the circular contains the scoring rules for lease-purchases and leases of capital assets. In March 1992, GSA wrote to OMB

⁹According to an OMB official, the self-insuring part of the following definition applies to GSA because GSA is considered to be self-insuring for budget-scoring purposes. If an agency's lease is determined to be an operating lease, budget authority is required for the estimated total payments expected to arise under the full term of the contract or, if the contract includes a cancellation clause, an amount sufficient to cover the lease payments for the first year, plus an amount sufficient to cover the costs associated with cancellation of the contract. In a limited number of cases, where funds are self-insuring under existing authority, only the amount of budget authority needed to cover the annual lease payment is required to be scored. If an agency's lease is determined to be a capital lease, budget authority will be scored in the year in which the authority is first made available in the amount of the net present value of the government's total estimated legal obligations over the life of the contract. For both operating and capital leases, outlays will be scored over the lease term equal to the annual lease payments. For example, since GSA is considered to be self-insuring, a 20-year lease with a yearly rent of \$10 million would be scored against GSA's budget authority for each of the next 20 years as an operating lease. If it was a capital lease, the net present value of the \$200 million in total lease costs would be scored against GSA's fiscal year budget authority in the year lease payments began.

¹⁰*Budget Issues: Budgeting for Federal Capital* (GAO/AIMD-97-5, Nov. 12, 1996).

saying that after reviewing its nonprospectus inventory, as well as OMB policies and procedures, GSA concluded that nonprospectus leases should be considered operating leases for scoring purposes without the necessity of a case-by-case determination. In this letter, GSA stated that there was no practical way to implement a policy of determining whether each nonprospectus lease met the criteria for being considered an operating lease without severely damaging its ability to meet client-agency needs. GSA considered this view consistent with OMB's intent, as well as an operational necessity. In April 1992, GSA issued guidance on lease scoring in which it stated that all nonprospectus leases are to be considered operating leases unless the lease is a lease-purchase, the lease contains a nominal or bargain purchase price, or the lease is on government-owned land.¹¹ All nonprospectus leases that met one of these exceptions were to be scored as capital leases by the regions. All prospectus-level leases were to be scored at GSA's central office.

In October 1998, GSA announced it was no longer following the policy of considering most nonprospectus leases as operating leases. Since then, according to GSA officials, GSA has required regional offices to apply the appropriate criteria to all prospectus and nonprospectus leases and that copies of the resulting scoring be retained in the regionally maintained lease file. GSA headquarters is to review the scoring of all prospectus-level leases.

Two of the six scoring criteria used to determine an operating lease concern the term of a lease: that the lease term not exceed 75 percent of the estimated economic life of the asset and that the present value of the minimum lease payments over the life of the lease not exceed 90 percent of the FMV of the asset at the beginning of the lease term. According to GSA officials, GSA's leases generally meet the first of these two criteria. If GSA rents new space, it meets this criterion because it only has 20-year leasing authority and tax law specifies that a new building's economic life is longer than 30 years (30 yrs. times 75% = 22.50 yrs.). If GSA rents older space, it generally requires it to be upgraded, which extends the building's estimated economic life, thereby meeting this criterion. Thus, the remaining criterion that could affect the lease term is that the present value of the minimum lease payments over the life of the lease not exceed

¹¹Lease-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.

90 percent of the FMV of the asset at the beginning of the lease term. For example, if a lease has a 20-year term whose present value of the minimum lease payments exceeds 90 percent of FMV then by reducing the 20-year term, the present value of the minimum lease payments is reduced while the FMV of the asset remains the same. This lowering of the percentage relationship between present value of the minimum lease payments and 90 percent of FMV allows a lease to meet this scoring criterion. However, if a lease does not meet any one of the other four scoring criteria, the lease would be a capital lease no matter what the term.

Budget Scoring Impacts Some Leases, But Full Extent Is Unknown

Six of GSA's 11 regions identified 12 projects or leases for which the scoring process had affected the term of the lease. In one other region, according to a GSA official, GSA thought that the term of about eight other leases had been affected in the last 2 years but they could neither identify those leases nor the impact of budget scoring on the lease term. GSA officials from the other four regions said they could not identify any projects affected by budget scoring. Only 2 of the identified 12 projects—a lease for the Immigration and Naturalization Service and a lease for the Secret Service—were among the 39 prospectus-level projects reviewed, and none came from the 102 lease files we reviewed. According to GSA officials, other factors, such as the agency or the market, determined the term of these other leases. Table 1 lists the leases or lease projects that we or GSA identified as being affected by scoring.

Table 1: Leases or Lease Projects Whose Term Was Affected By Budget Scoring¹²

GSA region	Agency	Rentable square feet	How budget scoring affected the lease
2	FBI	15,000	Term reduced from 20 to 10 years.
3	Social Security Administration (SSA)	824,563	Term reduced from 20 to 10 years. ^a
3	FBI	131,169	Term reduced from 16 to 10 years and agency only wanted a 10-year lease.
5	Secret Service	76,200	Term reduced from 15 to 10 years.
5	FBI	126,912	Term reduced from 20 to 10 years.
7	Federal Emergency Management Agency	82,017	Term increased from 10 to 15 years with right to cancel after 10 years. This is a build-to-suit lease. Since the agency is generating the market, by going to a 15-year lease the lessor could get better financing thus reducing the lease costs.
10	Immigration and Naturalization Service	125,000	Term reduced from 20 to 10 years.
11	Department of Transportation	1,350,000	Term reduced from 20 to 15 years.
11	National Science Foundation	2,023 ^b	Term reduced from 11 to 8 years.
11	Drug Enforcement Agency	49,692	Term reduced from 20 to 18 years and loading dock dropped from project.
11	Federal Drug Administration	25,196	Term reduced from 5 years with 2-year options to 5 years only.
11	Department of Defense	16,675	Term reduced from 5 years with a 5-year option to 5 years only.
N/A	SEC	650,000	Term reduced from 20 years to 14 years.

Legend: N/A=Not Applicable.

^aThe lessor has submitted an unsolicited proposal to extend the lease by 15 years at lower rent if GSA will renew the lease now rather than waiting until lease expiration in September 2003. This is why it shows up on the Fiscal Year 2001 Capital Investment Plan.

^bThis is in net useable square feet.

Source: GSA and GAO.

According to GSA officials, during the planning for the Department of Transportation lease, it was realized that due to the rental rates in the District of Columbia, a 20-year lease would probably not satisfy the 90

¹²Either we or GSA identified these projects as ones that the lease term was affected by budget scoring criteria. This list includes leases that have not yet been awarded and leases and supplemental leases that have been awarded, as well as the SEC lease.

percent scoring criterion. In order to address this issue, GSA reduced the lease term to 15 years, estimating that the present value of the minimum lease payments for a 15-year lease would not exceed 90 percent of the FMV. For the SSA lease, according to officials, it was originally submitted as new construction but not approved. GSA then decided to do it as a 20-year build-to-suit lease,¹³ but when reviewed it was determined that it would be a capital lease because it did not satisfy the 90-percent scoring criterion. At OMB's direction, the lease was awarded as a 10-year lease because OMB thought that SSA space needs might be reduced in the future because of automation.

Factors Limiting the Identification of Lease Term Influenced By Scoring

Four factors limited the identification of leases affected by budget scoring, according to GSA officials. First, GSA did not begin determining whether each nonprospectus lease met the scoring criteria for being considered an operating lease until about October 1998. GSA issued guidance in 1992 that stated there was no practical way to implement a policy of determining whether each nonprospectus lease met the criteria for being considered an operating lease without severely damaging its ability to meet client-agency needs. Nonprospectus leases were to be considered operating leases unless the lease was a lease-purchase, the lease contained a nominal or bargain purchase price, or the lease was on government-owned land. Thus, it is unknown if nonprospectus leases would have been affected by scoring between 1992 and 1998. Second, prospectus-level leases were scored in headquarters until September 1998, and scoring records were not kept in the lease files that are maintained by GSA's regional offices. Third, GSA headquarters does not maintain documentation on whether the scoring process affected the lease term. According to a headquarters official, although GSA kept copies of scoring for prospectus leases, the records do not show whether the term was directly affected by scoring. Fourth, according to GSA officials, budget-scoring rules affect an unknown number of leases because if staff believe a project will be affected by budget-scoring rules, they reduce the term to avoid the potential scoring conflict. However, they do not formally score the lease and do not use the scoring rules as a tool to identify the best term. As of October 1998, GSA's regional offices were to score and document the scoring of both prospectus and nonprospectus leases, according to officials. However, the officials said that the files will contain only the final scoring sheets and not

¹³Build-to-suit refers to leased buildings that are constructed to meet a specific need of a GSA client-agency.

preliminary runs that might identify situations where a lease term was adjusted in order for the lease to score as an operating lease.

Overall Monetary Impact of 10-Year Leases Versus 20-Year Leases Is Not Known

We could not determine the actual monetary impact of reducing the lease term. However, we found two leases in which GSA requested 10-year and 20-year and 15-year and 20-year lease costs. GSA provided a consultant's report showing the difference between 10- and 20-year lease costs for another project and the SEC lease had 15- and 20-year lease costs. GSA did not identify these two lease terms as being affected by budget scoring. However, the SEC lease term was affected by scoring. According to GSA officials, GSA does not generally seek comparisons of short- and long-term lease costs in the solicitation process. Also, GSA officials stated that the use of a 20-year lease is only appropriate in certain situations, such as if the agency has a long-term need and the federal presence is large enough in the market to backfill the space with other federal employees if the needs of the requesting agency change over time. Also, they pointed out that in most cases it would be less costly to construct a federal facility to meet a long-term need than it is to lease. We previously reported that construction was usually the least costly approach for meeting long-term space needs.¹⁴ Further, GSA pointed out that other factors, such as market, location, and the agency's desires, affect the selection of the lease term.

While reviewing files, we identified two leases for which GSA had solicited offers for both 10- and 20-year and 15- and 20-year leases. The first lease was for a 20-year lease structured as either a 10-year lease with a 10-year option or a 20-year lease.¹⁵ The 20-year lease term was 3.24 percent less expensive per NUSF than the 10-year lease that was awarded. This lease was awarded as a 10-year lease with a 10-year option because the agency's long-range plans were unknown. Eight final offers showed that the 20-year lease ranged from 0 to 12.9 percent less expensive per NUSF than the 10-

¹⁴*Space Acquisition Cost: Comparison of GSA Estimates of Three Alternatives* (GAO/GGD-97-148, Aug. 6, 1997, and *General Services Administration: Comparison of Space Acquisition Alternatives—Leasing to Lease-Purchase and Leasing to Construction* (GAO/GGD-99-49R, Mar. 12, 1999).

¹⁵In analyzing the lease, the 10-year option is included in the analysis. Also, other factors such as free rent or a cash allowance that may be made by offerors have not been included in the analysis. We have calculated the cost differences based on cost per square foot. Further, GSA may use technical factors such as expandability and space efficiency along with cost in determining the best offer.

year lease.¹⁶ However, for two other final offers the 20-year lease ranged from .06 percent to 1.19 percent more expensive per NUSF than the 10-year lease. The second lease was for a 20-year lease structured as a 20-year lease with cancellation rights at 15 years or a 20-year lease. The 20-year lease term was 5.56 percent less expensive per NUSF than the 20-year lease with cancellation rights at 15 years for the offer selected for award. The contract was awarded as a 20-year lease with cancellation rights at 15 years. It is not clear from the file why this option was chosen. Four final offers showed that the 20-year lease ranged from 5.56 percent to 7.75 percent less expensive per NUSF than the 20-year lease with cancellation rights at 15 years. However, for two other final offers the 20-year lease was 5.99 percent and 7.97 percent more expensive per NUSF than the 20-year lease with cancellation rights after 15 years. Furthermore, a consultant's report on locating an FBI building in Texas showed that a 20-year lease was 32 percent less expensive per square foot than a 10-year lease. The consultant pointed out that the cost difference might be due to the specialized nature of the FBI building.

The SEC lease project had offers ranging from 10 to 20 years.¹⁷ For the successful offer, the 20-year lease costs and the 15-year lease costs were the same per RSF.¹⁸ Three other final offers showed that the 20-year lease costs ranged from 1.3 percent to 4.1 percent less expensive per RSF than the 15-year lease costs. One final offer included 10-year lease costs. This offer showed that 20-year lease costs were 8.8 percent less expensive per RSF than 10-year lease costs per RSF. Further, 15-year lease costs were 7.4 percent less expensive per RSF than 10-year lease costs per RSF. The difference identified between terms and costs in these three examples are not projectable to other leases because other factors such as market condition (whether rental rates are high or low) affect the cost of a lease.

¹⁶We dropped three other final offers because two had been withdrawn, and the data for the other one could not be clearly interpreted.

¹⁷The SEC Solicitation for Offers (SFO) allowed offers up to 650,000 RSF. The SFO allowed joint offers or allowed SEC to combine offers. We have included in our discussion only the four of eight final offers that ranged from about 546,000 RSF to 650,000 RSF. We did this to keep costs as comparable as possible.

¹⁸According to an SEC official, after receipt of Best and Final Offers, the offeror remaining in the competitive range reduced its price and offered a 14-year term. Accordingly, the cost per RSF for the 14-year lease SEC signed is not comparable to the 20-year lease and 15-year lease costs in the prior offer of the successful offeror.

In testimony before the Subcommittee on Public Buildings and Economic Development, House Committee on Transportation and Infrastructure, on May 15, 1997, a private industry real estate official testified that a 20-year lease term could have annual rental rates as much as 33 percent less expensive than a 10-year lease and 13 percent less expensive than a 15-year lease. Also, he testified that a 15-year lease term can be as much as 23 percent less expensive than a 10-year lease. He further stated that renewal options in a lease are more advantageous than having to renegotiate a new lease for the same location. While GSA officials agree that a long-term lease generally has a lower cost than a short-term lease, they could not quantify the difference between a 20-year lease or 15-year lease and a 10-year lease. Also, they stated that it is generally less costly to construct a federal facility to meet a long-term need—20 years or more—than it is to lease. Furthermore, they pointed out that other factors such as the desires of the agency and the market must be considered along with cost.

For nine GSA lease acquisitions, we previously reported that construction would have been less costly in eight of the nine cases, with the range of cost differences being from a negative \$.2 million to a positive \$48.1 million for construction.¹⁹ For 11 cities throughout the country, we reported that to build a hypothetical 100,000 square foot office building versus obtaining a 20-year lease, the estimated range of cost savings for construction versus leasing was from \$.3 million in St Louis, MO, to \$14 million in Washington, D.C.²⁰

Also, we previously reported that the budget scoring rules favor leasing and that 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.²¹ This would entail scoring up front the present value of lease payments covering the same time period used to analyze ownership options. Applying the principle of up-front full recognition of long-term costs to all options for satisfying long-term space needs—purchases, lease-purchase or operating leases—is more likely to result in selection of the most cost-effective alternative than the current scoring rules would.

¹⁹The negative result is due to the low lease cost for warehouse space offered for this acquisition.

²⁰ [GAO/GGD-99-49R](#), Mar. 12, 1999.

²¹ [GAO-01-578R](#), June 5, 2001.

Factors Other Than Scoring That Influence Lease Term Selection

According to GSA officials, while scoring does affect the term of some leases, the term of most leases is determined by various factors other than budget scoring, such as the type of space—existing or build-to-suit—lease term desired by the agency, rental market condition, and location of the structure. The importance of each variable may be different for each lease.

GSA officials said that for existing space, lease terms do not usually exceed 10 years. This has been a standard practice for some time. If the requirement is for build-to-suit space, then the term of the lease may have to be longer than 10 years to accommodate the lessor's ability to finance the building. It is these build-to-suit leases that are most likely to be affected by scoring because the lessor must have a longer term lease to get financing for a new structure.

The lease term to which the agency is willing to commit is another important factor. GSA officials stated that some agencies told GSA that the agency only has authority to commit to a maximum of a 10-year lease. Other agencies only want leases of 10 years or less because of the changes occurring within the agency, such as downsizing or consolidation. An example, according to GSA officials, is the Internal Revenue Service; because of downsizing it does not want to sign a lease longer than 10 years.

The rental market conditions also affect a lease's term. GSA does not want to commit to a long-term lease when the market rent is considered high. Conversely, if market rent is low, GSA will consider a longer term lease, according to officials. An example is a lease for the Customs Service in Seattle, WA, for which GSA did not want a long-term lease because the current rental rates were high.

Location becomes an important factor because GSA is required to take space back from an agency with only 120 days notice. So in areas with a limited federal presence, GSA does not want to commit to leases where the space cannot be easily back filled with other federal agency employees, according to GSA officials. For example, in small towns, GSA would not want to commit to a lease term longer than an agency wanted when it is the only federal agency in the location. GSA would not be able to find another federal tenant for this space.

Conclusions

Although efforts to address budget-scoring rules did result in shorter term leases in some cases, we could not determine the total number of leases where the term was actually affected by budget scoring because of GSA's

documentation process for scoring leases. Further, while a shorter term lease can be more costly than a longer term lease, we could not determine the actual overall monetary impact of shorter lease terms because GSA does not generally seek comparisons of short- and long-term lease costs in the solicitation process. In addition to having some effect on the lease term, our previous work has shown that budget scoring can affect the government's decision whether to construct or lease a facility. Also, we have previously reported that the budget-scoring rules have the effect of favoring leasing and that 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 or construction.

Because of the overall effect budget scoring appears to be having on the acquisition of real property, we plan to address the effects of budget scoring on real property acquisition as part of a governmentwide review of real property management we recently initiated.

Scope and Methodology

To address identifying leases affected by scoring, we reviewed OMB's guidance on scoring leases (Circular A-11, Appendix B, and Circular A-94), interviewed GSA officials in headquarters and all 11 regions, and reviewed 102 active lease files with terms from 10 to 19 years and 100,000 RSF or more in GSA regions 3, 7, 8, and 11, which were the 4 regions with the most leases meeting our criteria of 10 to 19 years and 100,000 RSF or more. We dropped 8 lease files from our original selection of 110 files because the files could not be located during our visit or had been moved to other locations prior to our visiting the region. We did not verify the accuracy of the data used to select the lease files. To determine monetary impact of scoring on the lease term, we reviewed congressional testimony, previous GAO reports, 102 GSA lease files, and 8 final offers for the SEC lease; and we interviewed officials in GSA headquarters, all 11 GSA regions, and SEC. To identify other factors influencing lease term, we reviewed 102 active GSA lease files and interviewed GSA headquarters and regional officials.

We conducted our review at GSA and SEC between October 2000 and July 2001 in accordance with generally accepted government auditing standards. We obtained comments on a draft of the report from GSA and SEC.

Agency Comments

On August 10 and 14, 2001, we received written comments from the Associate Executive Director, SEC, and the Commissioner of GSA's Public Buildings Service (PBS), respectively. The SEC official provided clarifying information, which has been included in the report. The PBS Commissioner basically agreed with us that budget scoring is affecting the lease term and provided additional comments, which he believes support this position. The first comment stated that seasoned leasing specialists said that the use of 20-year leases had declined since the Congress passed the Budget Enforcement Act of 1990. While this may be true, GSA did not have documentation on the impact of budget scoring on the lease term, other than for the cases cited. Also, it is possible that other factors, such as market conditions, contributed to the decline in the use of 20-year leases. Second, GSA stated that the National Capital Region sets the term of all the above-prospectus leases it submits as part of its capital plan at 10-years, except in certain cases, to avoid budget-scoring problems. For the fiscal year 2000 and 2001 prospectus-level leases that we reviewed, this is accurate. However, prior to fiscal year 2000, both the Patent and Trademark Office and the Department of Transportation leases were submitted for longer terms, 20 and 15 years, respectively. Third, GSA said while options to renew a lease were advantageous, it did not generally seek them for leases with 10-year terms because options are scored as part of the 90-percent scoring criterion and could result in a capital lease. While GSA is correct that OMB guidance requires options to be considered in scoring leases, there is an exception to this rule. According to OMB's guidance, agencies do not have to include an option for budget scoring if exercising the option would require additional legislative action. Lastly, GSA raised the issue of short-term leases resulting in increased rental costs in some cases because they lead to shorter amortization periods and higher mortgage payments for lessors who use federal leases as collateral for financing. While the report shows that in certain cases shorter term leases are more expensive than long-term leases, we did not look at whether this increased cost was driven by shorter amortization periods and higher mortgage payments. GSA also made some technical comments, which we have reflected in the report where appropriate. We have included GSA's written comments in appendix I.

We are sending copies of this report to the Chairmen and Ranking Minority Members of congressional committees with jurisdiction over GSA and SEC. We are also sending copies to the Administrator, GSA, and the Chairman, SEC. Copies will also be made available to others upon request.

Key contributors to this report were Ronald L. King and Thomas G. Keightley. If you have any questions, please contact me or Ron King on (202) 512-2834.



Bernard L. Ungar
Director, Physical Infrastructure Issues

Appendix I: Comments From the General Services Administration



GSA Public Buildings Service

AUG 14 2001

Mr. Bernard L. Ungar
Director, Physical Infrastructure Issues
General Accounting Office
Washington, DC 20548

Dear Mr. Ungar:

We are pleased to provide the following comments on your draft report "Budget Scoring Affects Some Lease Terms but Full Extent is Uncertain." We solicited comments on the report from Public Buildings Service Portfolio Directors in each of our eleven regions as well as from a seventy-person network of GSA leasing professionals nationwide. The comments below reflect the feedback we received from these individuals.

GSA believes that the requirements that a) leases be scored and b) the net present value of capital leases be appropriated at the inception of the lease limits the terms of the leases that GSA can enter into. There is strong evidence that the scoring requirement shortens lease terms at GSA. Aside from the anecdotal evidence you cite in your study, this evidence includes the following.

- According to seasoned leasing specialists, GSA used to enter into numerous twenty-year leases before 1990, when Congress passed the Budget Enforcement Act. Now twenty-year leases are a rarity.
- In general, GSA leasing personnel do not develop lease requirements with terms that are likely to score as capital leases. Although there are exceptions, the rule of thumb is that leases with terms of more than twelve or thirteen years may score as capital leases. So that it does not run afoul of the scoring rules, the GSA National Capital Region sets the term of all the above-prospectus leases it submits as part of its capital plan at ten years.
- It is always cost-effective for GSA to have a unilateral option to renew a lease. If GSA exercises an option to renew rather than procures other space at the end of a lease term, we save significant administrative and tenant build-out costs for the government. Under OMB's scoring rules, however, options must be counted along with the firm term in applying the 90 percent scoring criterion. Therefore, leases with options are treated as long-term leases. Since such leases generally score as capital leases, we typically do not obtain options if they take the term beyond ten years.

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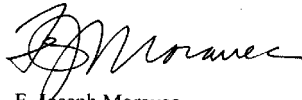
- 2 -

We also know that per-square-foot lease rates are frequently higher for short-term leases than they are for long-term leases. When possible, for instance, many lessors use Federal leases as collateral for financing. Shorter lease terms can still be financed, but generally lead to shorter amortization periods and higher mortgage payments. These higher mortgage payments are passed on to GSA in the form of higher rents.

The statistical data obtained by GAO suggests that budget scoring has an effect on lease terms but the extent of this effect is not quantifiable. Therefore, we suggest that the caption "Budget Scoring Has Limited Identifiable Impact On Lease Terms" be changed to make this point clear.

For the record, we have also provided editorial comments on the report informally.

Sincerely,



F. Joseph Moravec
Commissioner

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