

Statement of

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before the

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Mr. Chairman, I am pleased to participate in this hearing on H. R. 630 and to summarize findings of a recent Congressional Budget Office (CBO) report titled, The Federal Buildings Program: Authorization and Budgetary Alternatives. The study, requested last year by the chairmen and ranking minority members of the Senate Committees on the Budget and on Environment and Public Works, focuses on Congressional concern for strengthening program review and cost disclosure, reducing long-term federal costs, and assuring an appropriate level of federal construction and ownership of work space. My statement will highlight two major topics addressed by the CBO report and H. R. 630:

- o Strengthening public buildings authorization and budgeting; and
- o Choosing whether to acquire space by leasing or by federal construction.

AUTHORIZATION AND BUDGETING

As in many other federal programs, funding for space needs undergoes a two-part Congressional approval process--authorization and appropriation. Critics, the General Accounting Office among them, have charged that the

system could be strengthened, and cite problems with both steps in the approval process.

Planning and Authorization Deficiencies. Under the current system-- which does not require an annual authorization--authorizing committees review perhaps 100 or so prospectuses each year. Prospectuses do not all come in at one time and do not provide information on how relative project priorities may be evaluated. Coupled with long-run planning deficiencies, it is most difficult to weigh the relative merits of each proposal and to coordinate the authorization and appropriations processes.

Long-range planning at the General Services Administration is still in a formative stage. Although advances have been made in recent years, the planning documents do not readily permit consideration of the Federal Buildings Fund (FBF) program within the spending targets set by the budget process or of acquisition alternatives that would offer different programmatic and budgetary impacts in either the short or long run. The information currently provided also fails to facilitate review of consequences that would result from changing key planning assumptions--such as those covering federal employment levels and space utilization.

Overall, the annual planning and authorization requirements of H. R. 630 would seem to improve the basis for Congressional decision-

making and to facilitate closer integration of the authorization and budgetary processes. I will defer to representatives of the GSA concerning any administrative problems that might be encountered in complying with the numerous reporting requirements in the bill. In addition, some of these requirements go beyond notification, dealing with Congressional committee approval and disapproval of actions by the executive branch. This is an area not covered in the CBO report, and I understand the committee will be carefully scrutinizing the bill's language in view of the recent Supreme Court decision on legislative veto provisions (*Immigration and Naturalization Service v. Chadha et al.*).

Appropriation and Cost Measure Problems. The cost measures currently used in the FBF budget accounts give rise to difficulties in assessing long-term cost commitments, and most importantly, in comparing requirements for public buildings against other federal responsibilities. Two aspects of the current budget framework prove especially troublesome--the disclosure of costs for new multiyear lease contracts, and the absence of budget authority and gross outlays in the FBF account.

With regard to multiyear leases, the cost of full long-term commitments are difficult to assess because the appropriation language limitations and associated budget measures used for the FBF account only show the costs being paid in a given year--not the remaining out-year costs of multi-

year contracts. The CBO report notes that a similar problem arose in 1975 over the budgetary treatment of multiyear contracts entered into by the Department of Housing and Urban Development (HUD) with local public housing authorities. In that case, Congress decided to fund the full known cost of multiyear contracts in the year contracts were awarded. The provisions of H. R. 630 would enact a somewhat similar accounting change for the FBF program as a way of providing more realistic assessment of out-year leasing costs. In limiting the change to new leases with terms of more than five years, the increase in obligational or budget authority would probably be about \$300 million per year. As in the HUD case, this accounting change would not directly affect program levels or budget outlays.

With regard to budget authority and outlays, problems arise concerning the disclosure of overall program costs. Federal buildings program activities are financed by standard level user charges (SLUCs)--that is, rent-like fees collected from tenant agencies. These collections are deposited into the Federal Buildings Fund from which funds are committed to program activities subject to limitations set forth in language enacted in the annual appropriation bills. These limitations serve a purpose similar to the enactment of appropriations, but they do not create budget authority or gross outlays in the FBF account.

The absence of budget authority and the netting of funds into and out of the FBF account results in outlay amounts so small that they usually receive little notice as a significant cost item throughout the Congressional budget process. In 1982 for example, the FBF account shows negative outlays of \$92 million--meaning only that SLUC and other collections exceeded gross disbursements by this amount. This treatment helps to insulate space acquisitions decisions from pressures to curb short-term federal spending, but in doing so it masks the full cash demand of the program on the U. S. Treasury. The 1982 cash disbursements--outlays--were reported as a minus entry but gross disbursements for various FBF costs were actually just under \$2 billion.

For certain major activities such as construction, repairs, and leasing, H. R. 630 seems to call for enactment of appropriations and associated budget authority--apparently in lieu of relying on language limitations in annual appropriation acts. If this interpretation is correct, the bill would improve the disclosure of FBF costs and permit them to be weighed against those of other programs reviewed in the budget process. The Committee may want to consider clarifying the language of the bill on this point and to bring all FBF activities under the requirement for enactment of budget authority. If so clarified, H. R. 630 could maintain the current SLUC mechanism that charges agencies for rent and, at the same time, improve budget accountability.

LEASING VERSUS CONSTRUCTION

A major part of the CBO study addresses whether the present system biases federal office space acquisition decisions toward leasing rather than federal construction and ownership; and if so, whether the government passes up the opportunity to capture long-term economies. In short and at the risk of oversimplifying, our analysis confirmed that despite the opportunity to achieve significant long-term economies through construction, the decisionmaking framework shows a bias toward leasing in the acquisition of office space. I would like first to elaborate on both points--the potential economies and the systematic biases, and then discuss how H. R. 630 deals with each.

The Economies of Federal Ownership

CBO analysis of comparative cost data supplied by GSA on 126 projects confirms that, in many cases, construction of larger projects offers long-term savings relative to leasing when comparing both the cash disbursement effects on the FBF budget and present values that adjust for the fact that costs for the two methods of acquisition occur over different periods of time.

FBF Cash Disbursements. In the short term, construction and ownership are almost always more costly than leasing because they require large initial disbursements. In addition, construction costs are higher to the federal government than to private-sector developers. According to a 1976 study for GSA, various statutes and regulations that govern federal projects may increase net costs per square foot by as much as two-thirds.

From a long-term perspective, however, conditions in widely varying local real estate markets can set rents high enough so that the accumulation of payments the government would make for leased space may eventually exceed the high costs of federal construction. The CBO analysis showed, for example, that over 34 years, leasing commercial space of 100,000 square feet or more could typically result in cumulative GSA disbursements exceeding those of construction by about 40 percent. The outlay comparisons were based on 1980 prices and thus did not consider the impacts of future inflation. If all recurring annual costs for repairs, operations, and rents increased at an annual 5 percent rate relative to the fixed costs of construction, GSA would disburse 93 percent more funds under leasing after 34 years than it would if it had constructed similar space. Such differences in FBF disbursements may largely occur because rents for commercial office space are often set to recoup costs within 15 years or less—even though buildings generally have a longer useful life.

Present Values. Though useful in some respects, the FBF budgetary comparisons I have just described disregard certain key factors--specifically, that expenditures for leasing and construction occur over different periods of time, that an owned building has some residual value after its useful life, and that federal properties are usually exempt from local real estate taxes. When making present-value comparisons that take these factors into account, CBO again found that, compared to leasing, construction offers significant opportunities for savings--provided the real cost of borrowing (expressed as the discount rate) stays below 5 percent. This conclusion is supported by a 1981 study undertaken by GSA and by a detailed CBO analysis of the data base used in that report. Four qualifications should be made concerning our findings:

First and most important, the results are highly sensitive to the particular discount rate used in the present-value cost comparisons of leasing and construction. Inserted for the record is a table showing, at six different real discount rates, the percentage of choices supporting construction over leasing and the associated savings. The table shows, for example, that at the highest discount rate shown, 7 percent as prescribed by the Office of Management and Budget in 1972, only one-third of the comparisons favor construction over leasing, with average savings of 9 percent; but with a discount rate of 3 percent--the basis for which I will discuss later--

almost two-thirds of the comparisons favor construction, with savings averaging 30 percent.

INCIDENCE AND DEGREE OF PRESENT-VALUE SAVINGS FROM CONSTRUCTING RATHER THAN LEASING UNDER SIX DISCOUNT RATES (In percents)

Real Discount Rate	Comparisons Supporting Construction ^{a/}	Average Savings (Relative to Leasing) in which Construction Is Less Expensive	Average Cost Increase in which Construction is More Expensive
2 percent	83	31	49
3 percent	64	30	39
4 percent	58	24	51
5 percent	45	20	56
6 percent	36	16	62
7 percent	34	9	77

SOURCE: Congressional Budget Office.

- a. Results weighted to reflect amounts of leased space in areas where projects were compared.

As a second qualification, the CBO analysis showed that results are highly sensitive to both project size and weighting for the amount of GSA-leased space in project localities. Such weighting recognizes the varying opportunities available in different localities to change the mix of

leased and government-owned space. With regard to building size, the analysis showed that the construction option for relatively small projects--those under 100,000 net square feet of office space--does not yield savings. Because of differences both in opportunities and in project size, it is appropriate that H. R. 630--in contrast to previous proposals--would not require that the mix between leased and government space be based on a predetermined percentage of total inventory.

Third, the CBO cost analysis focused mainly on construction and leasing. Recent news reports on purchases of existing commercial buildings draw attention to another alternative that could reduce federal space acquisition costs. In this regard, the committee might want to insure that GSA has adequate authority to fully pursue the purchase of commercial facilities, including those it leases.

Finally, other factors--such as the opportunity to control building design through federal construction, or the space management flexibility afforded by leasing--may play as important a role in space acquisition decisions as economic factors do. The need for maintaining short-term flexibility may be especially important at this time in view of GSA planning assumptions that anticipate reductions in federal employment levels and in the amount of space used per worker.

Pro-Leasing Biases

Even though federal ownership often offers attractive long-term economies, the CBO review supports a common complaint that the current system biases office space acquisition decisions in favor of leasing. The biases derive both from the prescribed discount rate in cost-comparison guidelines and from certain structural and fiscal constraints. After summarizing the nature of these biases, I would like to conclude my testimony by commenting on how H. R. 630 addresses them--recognizing that important short-run budgetary considerations always have a strong, and sometimes necessarily overriding, influence on long-term capital investment decisions.

Cost-Comparison Biases. Before space acquisition requests are submitted to the Congress, the Office of Management and Budget (OMB) requires GSA to prepare a present-value comparison of alternative methods for obtaining space. Present-value analysis permits comparison of the cost advantages and disadvantages associated with different methods of acquisition, adjusting fully for the different timing of expenditures. To make a fair comparison, costs should be reduced to a common time frame. This is important because the earning power of money changes over time: a dollar available today is worth more to the government than one available tomorrow; and conversely, waiting to spend a dollar later provides an

opportunity to put it to other uses. Present-value comparisons achieve a common pricing basis through use of a real interest rate, or rate of return, that places costs or values at the same point in time.

Issued in 1972, OMB guidelines prescribe a rate of 7 percent, based on an estimated rate of return on general-purpose real property leased from the private sector. According to GAO, a rate based on long-term Treasury borrowing costs represents a more appropriate measure, because a discount rate should reflect the value of federal, not private-sector, resources. This approach assumes that the government acts like a private investor to maximize its internal financial position rather than trying to effect an efficient allocation of resources in the economy as a whole.

Under the GAO approach, however, an incongruity emerges. Because rental rates under a lease include investors' borrowing costs, using generally lower federal borrowing rates to discount would overstate leasing costs. Treasury borrowing rates are lower than private rates of equal maturities, because private-sector investments are subject to a risk of financial failure. Adding a risk charge to federal borrowing rates would help correct the incongruity noted in the GAO approach. The CBO analysis of historical data over the past two decades (1963-1982) shows that adding an average risk factor to real federal borrowing rates suggests a discount rate of 3 percent.

This alternative rate, which reflects borrowing costs rather than rates of return, is considerably lower than the present OMB rate.

Some analysts might favor a lower discount rate based solely on Treasury borrowing without adding a factor for risk, while others might favor higher rates based on estimated returns to society through private-sector investments. In any event, choosing a discount rate involves some degree of uncertainty and a different rate may become appropriate as borrowing experience changes over time. In view of this uncertainty, H. R. 630 appropriately does not set a particular discount rate in law. This might be a good time, however, for the Administration to review the current rate, which was set nearly a decade ago. Perhaps the legislative history of the bill under consideration could cover this point.

Biases from Structural and Fiscal Constraints. The CBO report also describes pro-leasing budgetary biases under current practice that result both from the structure of the FBF account and from the pressures of fiscal considerations.

The structure of the FBF account biases decisions toward leasing primarily for two reasons. First, unlike budgetary accounting practices for construction, total long-term costs under lease contracts are not recorded in the year such contracts are awarded. In the short run, therefore, leasing

presents the more attractive alternative; costs are spread out, imposing smaller immediate demands on fund resources. Second, because program levels are limited by standard-level user charge (SLUC) collections, it is difficult to increase the level of capital investment and thus change the mix of owned and leased space. In fact, the resources available since the creation of the FBF could not have covered the higher level of commitments that would have been required to accommodate less leasing.

Several provisions in H. R. 630 would help correct both types of structural bias. First, the bill would require budgeting for the full-year cost of leasing with terms of more than five years. Second, the bill authorizes the appropriation of additional capital to the fund as a supplement to SLUC resources. Two other provisions--changes in the basis for setting SLUC assessments and authority to borrow from the Treasury-- would also provide additional sources of funding through internal budgetary accounting. But they seem to complicate unnecessarily the already highly complex and often confusing funding arrangements for FBF. In the interest of keeping the budget from getting more complex, the Committee might want to consider deleting these provisions. If this were done, the structural bias could still be addressed by relying on the more straightforward route of direct appropriations to supplement SLUC funds when necessary.

Regardless of what structural changes are made in the budgetary treatment of the FBF program, decisions in favor of leasing may result from a desire to minimize short-run government spending. Leasing always results in substantially lower near-term outlays compared to construction. The balancing of immediate budgetary and economic requirements against those of the longer term is a task that the Executive and the Congress share and that will almost always influence decisions about federal buildings just as it does those about other federal programs. Hopefully, the requirements for long-range planning and closer coordination of the authorization and planning processes set forth in H. R. 630 will lead to more informed decisions concerning such tradeoffs.

In conclusion, Mr. Chairman, I believe that the legislation now under consideration would help correct many of the problems set out in the CBO report on the federal buildings program. I hope the Committee will find the report and my observations useful in completing their action on this legislation. I would be pleased to answer any questions the Committee may have.