

# **CBO TESTIMONY**

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Statement of  
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Congressional Budget Office

on the  
Lease-Purchase  
Scorekeeping Rule

before the  
Subcommittee on Legislation and National Security  
Committee on Government Operations  
U.S. House of Representatives

September 20, 1994

## **NOTICE**

This statement is not available for public release until it is delivered at 10:00 a.m. (EDT), Tuesday, September 20, 1994.



**CONGRESSIONAL BUDGET OFFICE**  
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WASHINGTON, D.C. 20515

Mr. Chairman and Members of the Subcommittee, I appreciate this opportunity to discuss the issues surrounding H.R. 2680--legislation to change the scorekeeping rule for lease-purchases of federal buildings.

My statement today focuses on four points:

- o What is the lease-purchase scoring rule, and why do we have it?
- o What are the advantages and disadvantages of this rule?
- o What would happen if the Congress enacted H.R. 2680 and changed the rule?
- o What options, other than H.R. 2680, would encourage the cost-effective acquisition of space?

The Congressional Budget Office (CBO) has concluded that changing the scoring of lease-purchases would not be beneficial and that the government should take other steps to improve the process for acquiring space. Such steps might include preparing an overall strategic plan for space acquisition, improving procedures for giving the Congress information about the most cost-effective means of acquiring space, and changing the budgetary treatment of operating leases.

## ORIGIN OF THE LEASE-PURCHASE SCORING RULE

The lease-purchase rule deals with how the budget records the acquisition of buildings and other capital assets by the federal government. The government can obtain the use of a capital asset by:

- o Purchasing the asset outright--either by acquiring an existing asset or by building a new one. Purchasing is the government's most common means of acquiring buildings, military weaponry and equipment, and other physical capital assets (such as computer systems). The federal budget records the cost of such assets at the time of acquisition or construction.
- o Entering into a lease-purchase arrangement. A lease-purchase is the same as a purchase except that the federal government pays for the asset over a longer period of time and owns it at the end of the lease period rather than immediately. Everything else being equal, a lease-purchase is more expensive than a purchase because of the higher financing costs incurred by the private sector.
- o Entering into an operating lease. In this type of lease, the government does not take ownership of the asset. Operating leases may be cost-effective when the government has only a temporary need for an asset.

In such a situation, purchasing the asset and then selling it off again when the use is ended may not make sense. For long-term use, an operating lease is almost always a high-cost way to acquire a capital asset.

- o Entering into a capital lease, which is different from an operating lease in that the government consumes most of the useful life of the asset during a capital lease. A capital lease is almost always more expensive for the federal government than purchasing the asset.

### History of Lease-Purchases

In the latter half of the 1980s, the Congress enacted several laws to authorize agencies to enter into lease-purchase contracts with private-sector developers for federal office space. The federal government would agree to make annual lease payments to the developer, usually for 30 years. At the end of that period, the government would own the building. These arrangements were essentially federal construction projects, except that they were financed by private developers rather than through Treasury borrowing. The laws either implicitly or explicitly allowed agencies to sign such contracts without regard

to the Anti-Deficiency Act and specified that only the first year's lease payment was to be recorded as the government's initial obligation.

On the strength of such authorizations, the agencies signed binding contracts with developers. In some instances, the contract authorized the developer to raise financing needed for the building by promising the full faith and credit of the U.S. government, in the form of federal agencies' annual rental payments for the space, to pay off the developer's lenders. In all of these lease-purchase arrangements, the federal government bore most or all of the risk associated with the construction of the buildings.

### Creation of the Rule

The Congress and the Administration became concerned that federal agencies were, in effect, purchasing assets through long-term, binding commitments without appropriation action and without recognizing those commitments on the budget's ledgers. Moreover, they realized that the financing for such projects cost more than if the federal government had built them itself using funds from the Treasury, which can borrow money at a lower interest rate than private developers. As a result, the conference report on the Omnibus Budget Reconciliation Act of 1990 included specific instructions to the Office

of Management and Budget (OMB) and CBO for scoring lease-purchase arrangements. Rather than record obligations and outlays on an annual basis, the budget is to treat lease-purchases in the same manner as purchases.

In its Circular A-11, OMB has issued definitions and instructions for implementing the scorekeeping directives. These procedures require that budget authority for lease-purchase arrangements be recorded in the amount of the government's full legal obligation in the year of the commitment. The scoring of outlays is determined by whether the federal government or a private party bears the risk. If the government bears the risk for the lease-purchase, the budget records outlays in the first year for acquisition of an existing building, or over the construction period (rather than the lease period) for construction of a new building. If the private party to the lease bears the risk--a rare arrangement--outlays are scored annually in the amount of the lease payment.

If the government does not take title to the asset at the end of the lease, the contract is deemed a capital or operating lease. For capital leases, the rule requires budget authority to be scored up front and outlays to be recorded over the term of the lease. For operating leases, both budget authority and outlays appear in the budget annually as the lease payments are made.

Since adoption of this rule, agencies have ceased to enter into lease-purchase contracts. The buildings the federal government has acquired have been obtained through the most cost-effective method: direct purchase. However, agencies are probably using expensive operating leases in some cases in which a direct purchase would be better.

#### **ADVANTAGES AND DISADVANTAGES OF THE LEASE-PURCHASE RULE**

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To counteract the budgetary incentive to use costly operating leases to acquire building space, H.R. 2680 would bring back the former scoring procedure for lease-purchases of public buildings, which treated them the same as operating leases. That procedure would then give agencies a budgetary incentive to use lease-purchases rather than direct purchases, even though direct purchases are less costly to the government in the long run.

Scoring budget authority and outlays for lease-purchases at the time the government makes the commitment has a number of advantages. First, the rule makes the budgetary treatment of lease-purchases financed by the private sector equivalent to that of direct purchases by the federal government. Lease-purchases for permanent space needs are more expensive than direct purchases, and the rule enables the budget to show that clearly.

Because such comparisons provide a budgetary incentive to choose the acquisition procedure most advantageous to the taxpayer, lease-purchases have largely died out and construction has continued.

Second, the rule best reflects the fiscal policy impact of a lease-purchase transaction. The effect of such transactions on the economy occurs when the building is built or acquired, not when the lease payments are made. Showing this effect at the appropriate time is important because one of the budget's primary functions is to measure the fiscal effects of government activities.

Finally, the lease-purchase scoring rule is consistent with the budgetary treatment of similar transactions. The building or acquisition of aircraft carriers, dams, space stations, air traffic control systems, Internal Revenue Service computers, prisons, and other capital assets is shown in the budget when the assets are acquired. Up-front scoring is also typical of other types of financial commitments the government makes, including promissory notes of the Federal Deposit Insurance Corporation, loan guarantee commitments under credit reform, and monetary credits issued by the Department of the Interior. In all of these cases, spending is recorded in the budget when the government makes its financial commitment, not when the obligation is paid.

The major disadvantage of the lease-purchase rule is that it does not create a level playing field for all methods of obtaining space for federal agencies. In particular, outlays for leases are scored on a year-by-year basis over the leasing period. This procedure creates a budgetary incentive for agencies to enter into leases rather than acquire or construct buildings, even though there is broad agreement that leasing space is more expensive than purchasing it if the space is going to be used for many years. Thus, the current scoring procedures measure the proper trade-offs between federal construction and lease-purchases, but they do not provide an accurate picture of the merits of these mechanisms compared with those of leasing space for a similar period.

The agencies' tendency to favor leases over ownership, even when leasing is acknowledged to be a more expensive way for the federal government to meet its long-term needs for space, predates the adoption of the lease-purchase rule by many years. Consider the following trend. In 1970, the ratio of space owned by the General Services Administration (GSA) to space leased was 75 to 25. By 1977, the ratio had dropped to 60 to 40, where it remained until 1987, when it began to drop again until it reached 53 to 47 in 1993. The methods of recording leases and purchases in the budget may have influenced that trend. Further study might help to illuminate both the causes and consequences of this trend, but it is not apparent that adoption of

the lease-purchase rule has significantly affected it or that enacting H.R. 2680 to eliminate the rule would ameliorate the trend.

#### CONSEQUENCES OF ENACTING H.R. 2680

If H.R. 2680 is enacted, CBO assumes that the budget would have to record future lease-purchase arrangements on a year-by-year basis. Because that change would result in more lease-purchases, it would affect both direct spending and discretionary spending under current budgetary procedures.

CBO has already prepared a cost estimate for H.R. 2680 (attached) that shows how direct spending would increase by several billion dollars if new scoring rules favored lease-purchases. Such an increase in direct spending associated with the bill could create obstacles for its consideration under current Congressional procedures.

Enacting H.R. 2680 would also affect the discretionary side of the budget. Spending for federal facilities is subject to the same constraints that apply to all other discretionary activities--the discretionary caps imposed by the Balanced Budget Act. These caps, which remain roughly constant through 1998, will become increasingly restrictive over the next few years as federal

salaries and program costs rise. The danger exists that the Congress and agencies will choose significantly more costly ways to pay for capital assets based on short-term scoring incentives rather than secure long-term savings for taxpayers.

In that context, changing the scoring of lease-purchases back to the pre-1991 approach raises two important issues. First, is it appropriate or desirable to give the acquisition of building space a budgetary advantage over other worthwhile uses of limited discretionary dollars? There are many items or programs for which increased government investment in the short term would produce long-term budgetary savings. Should buildings receive preferential treatment?

Second, eliminating the lease-purchase rule would be a change in budget concepts for purposes of the Balanced Budget Act. The Congress, in adopting and extending the spending caps through 1998, assumed that the lease-purchase rule would remain in place. If the rule was dropped, OMB would first have to estimate how many direct purchases would convert to lease-purchases and then reduce the caps by the appropriate amount--possibly by hundreds of millions of dollars a year. Thus, there is no assurance that abandoning the current method of scoring lease-purchases would make it any easier for the appropriations committees to fund the acquisition of buildings.

## ALTERNATIVES FOR IMPROVING DECISIONS ABOUT FEDERAL ASSETS

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We recognize that the current rule is incomplete to the extent that it does not eliminate a budgetary incentive for operating leases. However, the Congress and the Administration have not yet devised a superior rule. We believe that dropping the current scoring rule would be a step in the wrong direction. Indeed, if anything is to be done, we suggest that entering into leases should be made more difficult except when the government can clearly demonstrate that leasing would be more cost-effective than a direct purchase.

In many cases, leases would probably not be cost-effective. In its 1989 report titled *Federal Office Space: Increased Ownership Would Result in Significant Savings* and in subsequent testimony, the General Accounting Office (GAO) has stated that although operating leases for office space make sense for a short or uncertain period of time, the federal government could save significant amounts if it owned more of its space instead of leasing it over a long period. GSA, the federal government's principal real estate manager, has also studied this issue and reached basically the same conclusion. Because this position appears to have broad support, the government would be better off modifying the scoring procedures to reinforce it than reverting to old, unsatisfactory ways.

### Further Improve the Existing Scoring Rules

GAO has suggested in previous testimony that leases that could be clearly identified as long-term federal commitments to occupy space should be scored in a way that is comparable with the scoring of methods of federal ownership. Generating the numbers for such a comparison would not be difficult: one could estimate the current value of all the lease payments made over time and compare that amount with the up-front cost of construction, acquisition, or lease-purchase.

In fact, GSA already does this analysis for a 30-year period when it tries to fulfill requests for space from its client agencies. Such an analysis almost always shows that leases are not cost-effective over the long term. A new scoring rule based on such a presentation would be as likely to discourage such leases as the current rule appears to have discouraged lease-purchases and capital leases.

The key to making the budgetary treatment parallel with GSA's economic analysis would be to achieve consensus on which operating leases were essentially providing permanent federal space. If GSA signed binding, long-term operating leases (regardless of whether they had termination clauses), recording the costs of such leases up front would be an easy matter.

However, under the argument that tight appropriation caps will always push decisionmakers to find a way to avoid recording costs up front, GSA might sign leases for only one year at a time, which would cost even more (although no termination clause would be necessary). To discourage behavior that meets the letter of the law while violating its spirit, one would need a way to define some annual leases as, in effect, long-term leases and record the sum of the annual costs up front. However, reaching a consensus as to which one-year leases were permanent leases in disguise would probably be difficult. Thus, although calculating the budgetary numbers needed for such an expanded scoring rule would not be difficult, implementing the rule fully enough to avoid further gaming would encounter practical obstacles.

#### Improve the Information Available to the Congress

When trying to select the most cost-effective methods of acquiring various types of federal office space, decisionmakers should ask the following question: How much space does the federal government need in the future and for how long? Under current procedures, federal agencies tell GSA how much space they think they need and pay market rates for whatever GSA provides them with, regardless of whether the government owns or leases space. GSA asks for a package of resources that the Congress is likely to

approve (under the caps) and that will allow GSA to meet its customers' requests. To weigh GSA's request for funds against all the other requests, the Congress should have full information about the trade-offs between short-term spending for space and long-term needs--information that has not always been available to policymakers.

GAO has recommended that the Administration develop a long-term investment plan that estimates the federal government's need for space and compares the cost-effectiveness of all options. Such a plan would require a projection of the number of federal employees needing space (especially important because of the planned reduction in the number of federal employees by the end of the decade), a projection of how much of the space owned by the government will become unusable and how other such space could be repaired, and an assessment of employment cycles and how they might affect regional or city-by-city building configurations. Such an analysis could result in recommendations on the amount of owned space that the government ought to be acquiring for the long term and what the appropriate amount of temporary space should be. Implementing this recommendation would give the Congress the information necessary to be confident that it has a cost-effective building strategy. Improving the scoring rules so that they do not impede the process of cost-effective decisionmaking would help the Congress make full use of that information.

## CONCLUSION

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Although the lease-purchase rule was adopted to illuminate (and eventually end) one kind of expensive practice, it did not prevent all inefficient uses of taxpayers' dollars. Enacting H.R. 2680, however, would not remove the current incentive to make decisions about space that are not cost-effective, and it would probably make things worse. The government would make better decisions that would save the taxpayers' money if the Administration and the Congress adopted a strategic plan for acquiring space and changed the budgetary treatment of certain operating leases to put them on an equal footing with other ways of acquiring space on a long-term basis.



CONGRESSIONAL BUDGET OFFICE  
U.S. Congress  
Washington, DC 20515

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Robert D. Reischauer  
*Director*

May 26, 1994

Honorable Norman Y. Mineta  
Chairman  
Committee on Public Works  
and Transportation  
U.S. House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman:

The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2680, a bill to amend the Public Buildings Act of 1959 concerning the calculation of building transactions.

Enactment of H.R. 2680 would affect direct spending. Therefore, pay-as-you-go procedures would apply to the bill.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

  
for Robert D. Reischauer

Enclosure

cc: Honorable Bud Shuster  
Ranking Minority Member

# CONGRESSIONAL BUDGET OFFICE

## COST ESTIMATE

May 26, 1994

1. BILL NUMBER: H.R. 2680

2. BILL TITLE:

A bill to amend the Public Buildings Act of 1959 concerning the calculation of public building transactions.

3. BILL STATUS:

As ordered reported by the House Committee on Public Works and Transportation on May 17, 1994.

4. BILL PURPOSE:

The bill would direct that the budget record any contract for the purchase, lease-purchase, or lease of any building and its site as if the contract were entered into on September 30, 1990. This change would vitiate the current scoring rules that apply to funding for federal buildings. These rules took effect as the result of enactment of the Budget Enforcement Act of 1990.

5. ESTIMATED COST TO THE FEDERAL GOVERNMENT:

(By fiscal year, in millions of dollars)

	1994	1995	1996	1997	1998	1999
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<u>Direct Spending</u>						
Estimated Budget Authority	500	2,500	750	750	750	750
Estimated Outlays	200	1,800	500	500	500	500
<u>Spending Subject to Appropriation Action</u>						
Estimated Authorization of Appropriations	--	a	a	a	a	a
Estimated Outlays	--	a	a	a	a	a

a. CBO cannot estimate these amounts.

The costs of this bill fall within budget function 800.

### Basis of Estimate:

H.R. 2680 would direct the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) to treat (for budget scoring purposes) any contract for the purchase, lease-purchase, or lease of a public building as if the contract were entered into prior to fiscal year 1991.

In effect, this would remove constraints on the General Services Administration (GSA) that were imposed by the scoring rules adopted for 1991 and thereafter as the result of enactment of the Budget Enforcement Act (BEA) of 1990. In the case of a lease-purchase arrangement or a capital lease of a building, those scoring rules require agencies to record as an obligation of budget authority (at the time of signing the contract) the building's full cost to the federal government over the life of the contract. Before the BEA, agencies would often enter into multiyear commitments to lease a building or acquire a building through a lease-purchase arrangement but would record obligations only one year at a time in the amount of the annual lease payment. The scoring rules for the BEA were created to make the budgetary treatment of lease-purchase arrangements and other forms of building acquisition or leasing comparable so that the budget would reflect true cost differences. Acquiring a building through lease-purchase costs more than constructing or buying the building outright because lease-purchase requires private sector financing of the project, which is always more expensive than government financing.

### Direct Spending

The return to pre-1991 scoring procedures would make it easier for GSA to enter into lease-purchase arrangements and capital leases instead of operating leases because lease-purchase arrangements and capital leases would require much less up-front budget authority under the proposed scoring rules than under current law. As a result, CBO expects that GSA would replace many of the operating leases with lease-purchases and capital leases because GSA would no longer have to record obligations for a lease-purchase or a capital lease differently from an operating lease.

Scorekeeping rules require CBO to estimate the consequences of legislation under current budgetary procedures, even if the legislation seeks to change them. On this basis, CBO estimates that GSA actions stemming from enactment of H.R. 2680--increased use of lease-purchase arrangements and capital leases--would result in additional budget authority of \$3 billion and additional outlays of \$2 billion over the 1994-1995 period, and additional budget authority of \$750 million and additional outlays of \$500 million per year from 1996 through 1999. Because GSA could sign these agreements and commit the government to a future stream of payments without further Congressional action, the budget authority and outlays would constitute direct spending.

## Authorizations

If H.R. 2680 became law, CBO and OMB would score lease-purchases with lower up-front costs than a similar construction or acquisition projects. This may result in the Congress approving more lease-purchases in place of construction or acquisition projects, and may result in the Congress approving more projects altogether. When scored under current rules, this would increase the amount of budget authority needed in future years. CBO cannot predict the mix of projects the Congress may adopt, and thus, we cannot estimate the amount of such increases.

Switching from leased space in the private sector to federal ownership would reduce some of the need for future appropriations for rental of space because annual leasing costs appearing in the budget would fall as GSA replaces operating leases (for which funding is needed annually) with lease-purchases (for which funding is required up-front under current law). As a result, CBO estimates the appropriation for rental of space would fall by \$100 million in 1995 and by an increasing amount thereafter.

### 6. PAY-AS-YOU-GO CONSIDERATIONS:

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting direct spending or receipts through 1998. CBO estimates that H.R. 2680 would cause additional direct spending from the Federal Buildings Fund of \$200 million in 1994, \$1.8 billion in 1995, and additional amounts in years after 1995. Thus, the bill would be subject to pay-as-you-go procedures. The following table shows CBO's estimate of the pay-as-you-go scoring of this bill.

(By fiscal year, in millions of dollars)

	1994	1995	1996	1997	1998
Change in Outlays	200	1,800	500	500	500
Change in Receipts				Not Applicable	

### 7. ESTIMATED COST TO STATE AND LOCAL GOVERNMENTS:

Changing the incidence of construction projects, lease-purchases, and operating leases to acquire space for federal agencies could affect the amount of property that is subject to local property taxes.

Two shifts would affect the amount of property under federal ownership (and therefore not subject to local property taxes). First, increasing the number of lease-purchases and decreasing the number of construction projects would decrease federal ownership (and increase the property tax base) in the near term. (Under a lease-purchase agreement, ownership of the site remains in the private developer's hands until the end of the lease period, whereas for a construction project the federal government purchases the site at the outset.) Secondly, increasing lease-purchases and decreasing the number of operating leases would increase federal ownership (and decrease the tax base), but not until the end of the lease-purchase term. CBO cannot predict the mix of changes GSA would adopt.

8. ESTIMATE COMPARISON: None.

9. PREVIOUS CBO ESTIMATE:

On November 17, 1993, CBO estimated the budgetary impact of a similar proposal in the House Committee on Public Works and Transportation's amendments for H.R. 3400 (Title XI, Subtitle E). CBO's estimate of the 1994 direct spending impact for H.R. 2680 is less than for the provision in H.R. 3400 because of a later assumed enactment date.

10. ESTIMATE PREPARED BY: Mickey Buhl (226-2860).

11. ESTIMATE APPROVED BY:

  
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