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# Reforming Federal Property Procurement: The Case for Sensible Scoring

Dorothy Robyn Thursday, April 24, 2014

The federal government has a *real* problem. The government's inventory of "real property" (buildings, structures and land) is as large and diverse as the federal mission. However, the budgetary rules that govern investment in these assets are a blunt instrument that does serious collateral damage. Reforming these rules would allow the government to shrink its real estate footprint, modernize its legacy infrastructure for the 21st century, and save billions of dollars.

The federal government owns or leases about 360,000 buildings and 3.3 billion square feet of space—six times more than all the commercial office space in Manhattan. Although most of the buildings are located on military bases, the inventory also includes federal courthouses and office buildings, post offices, land ports of entry, IRS tax processing facilities, Social Security Administration call centers, FBI field offices, Department of Energy labs, veterans' hospitals, and other civilian offices. The federal real property inventory includes as well some 485,000 "structures"—everything from national monuments to dams and levees.

Like our nation's crumbling roads and bridges, the federal government's buildings and structures suffer from age and neglect. The Government Accountability Office includes federal real property management on its "high risk" list because of the deteriorating condition of many federally owned facilities and the government's resulting overreliance on costly leased space.

A major culprit in this crisis is the federal government's budgetary treatment ("scoring") of leases and public-private ventures, as laid out in a technical document that is unknown outside of federal real estate circles. The Office of Management and Budget (OMB) issued Appendix B of Circular A-11 in 1991 in response to a perfect storm of conditions in the 1980s that led federal agencies to abuse their leasing authority; most notable, the Department of Defense (DoD) used leases to acquire (non-combat) ships and aircraft. A-11 sets out criteria for distinguishing a capital lease, for which the net present value of the total cost of the lease must be recorded in an agency's budget (scored) in the year the lease is entered into, from an operating lease, which can be scored on a year-by-year basis.

Circular A-11 has had a dramatic impact on federal real property management. First, it ended the longstanding use of "lease-purchases" by the General Services Administration (GSA), among other agencies: under that arrangement, which is common in the commercial sector, the lease was structured so as to give the lessee

(government) eventual ownership of the building. Under A-11, any lease that results in government ownership is treated as a capital lease, making it unaffordable. Second, OMB and the Congressional Budget Office (CBO) have gradually extended the reach of A-11 to preclude most public-private ventures aimed at financing federal acquisition of capital assets.

OMB and CBO defend the A-11 scoring rules on two grounds. One is cost: lease-purchases and public-private ventures are forms of third-party financing, and it is invariably more expensive for the federal government to use third-party financing than to purchase a capital asset directly. That is so because even the best private interest rates exceed the rate at which the U.S. Treasury can borrow. The other justification for A-11 is transparency: like an installment plan, lease-purchases and public-private ventures “hide” the government’s real long-term cost commitment, leading to suboptimal decision-making in the annual budget process.

The scorekeepers' cost argument is narrowly correct—it *is* less expensive for the federal government to buy a building (or a building renovation) directly than to finance it privately. But their premise that federal agencies could cover the large, single-year funding spikes that such purchases require has proved false over a 23-year period of unrelenting budget pressure. The result has been a textbook example of unintended consequences: lacking the budgetary resources to meet genuine facility requirements, federal agencies have resorted to practices more costly—and no more transparent—than the ones A-11 was designed to combat.

One such practice is reliance on short-term operating leases to meet long-term federal facility requirements. Since 1990, GSA's inventory of federally owned space has increased only slightly, while its leased inventory has doubled in size (measured by the number of square feet). Leasing is generally more expensive than ownership, as the scorekeepers recognized, and short-term leases are more

expensive than long-term leases because they increases the lessor's risk.  GSA leases typically have only a 10-year term (a longer lease runs the risk of getting scored as a capital lease), even though GSA's federal tenants stay in their leases for much longer—27 years on average.  GSA Administrator Dan Tangherlini recently told Congress that it cost the federal government twice as much to lease as to buy or build a facility.

Consider the new (2008) Department of Transportation (DOT) headquarters, which GSA sited on the Anacostia River in Southeast DC in part to spur development there. GSA leases the 1.35 million square foot building, which was designed with DOT in mind, for $45 million a year under a 15-year operating lease (a 20-year lease would have been scored as a capital lease).  Under A-11, GSA was not allowed to negotiate a lease that would have given the government ownership of the building at the end of, say, 25 years or that would have included a major discount on the building's end-of-lease market price (another arrangement that is common in the private sector).  Thus, at the end of 15 years, having spent some $675 million for a building

that cost far less than that (around $400 million) to build and having no equity to show for it, GSA will have to extend the operating lease or re-compete the requirement. Even if the owner is willing to sell GSA the building at that point, the price will be far higher than the equivalent 2008 price because of all the federally anchored development that has occurred around it.

In addition to forcing federal agencies to rely on short-term leases to meet long-term facility requirements, A-11 has led agencies to postpone capital investment in their facilities. The agencies with the largest inventories—DoD, GSA and Veterans Affairs—have a backlog of unfunded requirements for major renovations and new construction whose price tag probably exceeds $100 billion. Although postponement has reduced federal expenditures and deficits in the short run, deferred investment is a bad strategy, as any homeowner knows: not only is it more expensive to operate a poorly maintained building but the cost to fix the problems multiplies over time. Moreover, although many agencies want to reduce their real estate footprint to free up funds for personnel and activities that

directly support their missions, the up-front cost of consolidation is prohibitive.  Covering that capital cost—including moving agencies from expensive leases into federally owned buildings—could save the government billions of dollars.

If unintended consequences are Exhibit A in the case against A-11, Exhibit B is what happened after OMB granted DoD a waiver from A-11 in 1997.  The Military Housing Privatization Initiative, in which the Services were allowed to partner with the private sector to address the lack of adequate housing for military families, has been wildly successful.  Developers have matched DoD's $2.3 billion investment by a factor of 6, generating 200,000 units of new and renovated housing built and maintained to market standards.  Although DoD considers family housing privatization its most important and cost effective effort to improve Service members' quality of life, the

scorekeepers see it as the horse that got out of the barn: CBO publicly criticized OMB for approving the initiative, and OMB has repeatedly tried to walk it back.

The A-11 scoring rules are a blunt instrument. They are a based verbatim on the Financial Accounting Standards Board rules for how corporations—corporations that can borrow money to fund capital investment—should treat a lease for tax and disclosure purposes. Scorekeepers' use of those rules to dictate how federal agencies should finance capital acquisitions is a questionable stretch. Moreover, there are better ways to address the legitimate concern that agencies will undertake projects that carry unacceptable financing costs. For example, rather than scoring the cost of a public-private venture in its entirety—the current all-or-nothing approach under A-11 that effectively precludes such ventures—OMB could score only the differential between the net present value of the actual cost and the cost of the project if it were federally funded.

With agencies desperate to address their facility needs, a cottage industry has emerged in search of ways to get around the A-11 rules. Enough with that! It is time for policymakers and scorekeepers to debate first principles. Scorekeepers will insist that the merits of public-private ventures and lease-purchases are beside the point; A-11 is only concerned with proper budgeting. But when "proper" budgeting causes the federal government to do dumb things, surely that is grounds for a discussion. The stakes are high. The time is right. Let the debate begin.