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RELEASED

Supervision Of Leasing Officers And Construction Versus Leasing Of Federal Buildings

B 118623

General Services Administration

FILE COPY - COMP. GEN.

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

B-118623

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JULY 27, 1972

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D C 20548

B-118623

Dear Senator Proxmire

Your letter of May 28, 1971, requested that we review the procedures of the General Services Administration (GSA) for leasing Federal buildings and referred to the following five specific areas of interest--(1) whether GSA was adequately supervising its leasing officers, (2) whether GSA was following its own regulations, (3) whether the GSA regulations were adequate to protect the Government's interest, (4) why the Federal Government was leasing so much space rather than constructing the necessary buildings, and (5) how much the taxpayers could have saved over the estimated lives of the buildings if the Federal Government constructed them rather than leased them

As agreed with your office, we furnished you with an interim report (B-118623, Sept 3, 1971) dealing with our findings on the second, third, and fourth areas specified in your letter This report deals with our findings on the first and fifth areas

SUPERVISION OF LEASING OFFICERS

The GSA regulations setting forth standards of conduct for employees are, in our opinion, adequate The standards, however, were not fully complied with in the case of the leasing officer discussed in the Washington Post article referred to in your letter

The Federal Property and Administrative Services Act of 1949, as amended (40 U S C 490), authorizes the Administrator of General Services to enter into lease agreements, not to exceed 20 years, for the accommodation of Federal agencies in buildings and improvements which are in existence or are to be erected by a lessor The Administrator has delegated the leasing authority to the Commissioner of Public Buildings Service (PBS) who has redelegated some of this authority to the Assistant Commissioners for Space Management and for Operating Programs and to the regional administrators

Some of the leasing authority, in turn, has been redelegated by the assistant commissioners and the regional administrators to regional leasing officers, referred to as realty specialists and realty officers

GSA regulations state that no lease may be executed without the approval of the Commissioner, PBS, if it falls into any of the following categories

1 The firm term of the lease is in excess of 5 years

2 The total rentals for the firm term of the lease exceed $1 million

3. The annual rental rate exceeds $5 a square foot of net usable area, including services

4 The amount of space to be leased is 25,000 square feet or more

Proposed leases falling into any of the above categories must be forwarded with complete documentation of the proposed action to the GSA Central Office in Washington, D.C , for review and approval The 11 leases mentioned in our interim report fell into one or more of the foregoing categories and consequently were approved by the Commissioner, PBS

Public Law 87-849 (18 U S C 208) requires an officer or employee of the executive branch or an independent agency to refrain from participating as a Government officer or employee in any matter in which, to his knowledge, he or his spouse, minor child, or partner has a financial interest The law, however, permits the agency of the officer or employee to grant an exemption in writing if the outside financial interest in a matter is deemed not substantial enough to have an effect on the integrity of his services

Executive Order No 11222, dated May 8, 1965, as amended, provides that employees not have direct or indirect financial interests that conflict substantially, or appear to conflict substantially, with their duties and responsibilities as Federal employees and that they not engage in financial transactions as a result of, or primarily relying upon, information obtained through their employment

Civil Service Commission regulations provide that each agency issue regulations and instructions implementing the requirements of the law and the Executive order and prescribe standards of ethical conduct and reporting requirements that are appropriate to the particular functions and activities of the agency

GSA, in accordance with the provisions of Executive Order No 11222 and with Civil Service Commission regulations, has issued regulations pertaining to standards of conduct for GSA employees The GSA regulations prohibit an employee from having a direct or indirect financial interest that conflicts substantially, or appears to conflict substantially, with his GSA duties and responsibilities The regulations require further that, in any case in which an employee finds that his official capacity calls for participation in a particular matter or transaction in which he might be considered to have a direct or indirect financial interest, he immediately disqualify himself from acting and so advise his office head in writing

The GSA regulations also state that employees in specified positions are required to file statements of employment and financial interests and to report any changes in a supplementary statement as of June 30 of each year Each employee whose official duties are in any way related to the acquisition or disposal of real estate or interests therein shall not directly or indirectly purchase any real estate, except for occupancy as a personal residence, unless a full disclosure of the proposed transaction is made in writing to the agency counselor--a top ranking employee designated by the Administrator to review all statements of employment and financial interests--and unless the written approval of the counselor is obtained

The article in the May 28, 1971, edition of the Washington Post referred to a GSA official who had a personal financial interest in a parcel of real estate upon which a developer proposed to construct a building for lease to GSA This official, employed by GSA since 1952 as a realty officer responsible for negotiating GSA leases, had held discussions with the developer

Although the official reported to GSA that he owned rental properties, he did not comply fully with GSA regulations on standards of conduct In October 1955 the official requested and received permission from GSA to engage in outside employment to "own and maintain dwellings for rent " In a May 1965 memorandum to his superior, he stated that he owned some low-cost residential units for rent

The official filed five statements of employment and financial interests with the agency counselor The first, in May 1966, showed that he owned 25 parcels of real estate, not including his personal residence In October 1967 he filed a supplemental statement showing that he had acquired five additional parcels His supplemental statements of March and September 1970 indicated no changes from the previous statements In June 1971 he filed an amended statement listing properties owned

Four parcels of real estate first reported in June 1971 should have been reported earlier Our examination of District of Columbia land records revealed that he had purchased one of these parcels in August 1966 and the other three in March 1968 The official informed us that he had apparently overlooked reporting the four parcels previously and that the nonreporting was not intentional on his part

The property at 1308 Potomac Avenue SE , Washington, D C , which he purchased in August 1966 and did not report until June 1971, was the property which the developer proposed to use, in part, as a site for an office building to be leased to the Government The official stated in an affidavit submitted to GSA that, at the time of the preliminary discussions with the developer, he had not known that the developer was planning to include his property at 1308 Potomac Avenue SE as part of the building site

The official informed us that he had not been aware of the GSA requirement that all persons whose duties are related to the acquisition or disposal of real estate must obtain written approval from the agency counselor before purchasing any real estate except for occupancy as a personal residence This requirement was published in the Federal Register on March 11, 1966, as part of the code of conduct for GSA employees and is included in a GSA handbook He told us that he had never requested permission to purchase properties and had never been told to request such permission

Although the official reported in October 1967 to the GSA agency counselor that he had acquired five properties after filing his first statement of employment and financial interests in May 1966, he was not questioned or notified about his noncompliance with the provisions of GSA's code of conduct which require written approval before purchasing real estate

On June 2, 1971, GSA suspended the official for a period not to exceed 30 days effective June 3, 1971, pending the results of an investigation of a possible conflict of interest involving real estate transactions The investigation revealed that he had violated the GSA standards of conduct in 1966 by purchasing property without receiving prior written approval of the agency counselor The report revealed also that the official, in violation of the GSA standards of conduct, had acted in his official capacity as a representative of GSA in meeting with a developer to discuss progress on a project which included the property in question

On June 16, 1971, the Commissioner, PBS, advised the suspended official of the findings of the investigation The Commissioner stated that the official's record of 25 years of Federal service and the absence of any evidence that his violations of the GSA standards of conduct were other than inadvertent were taken into consideration in weighing the actions to be taken The Commissioner therefore directed the suspended official to return to duty effective June 21, 1971, and reassigned him, without reduction in rank or pay, to a position which in no way involved contractual matters relating to interests in real estate

CONSTRUCTION VERSUS LEASING OF FEDERAL BUILDINGS

Our review of 10 of the 11 buildings leased by GSA which were mentioned in our interim report to you showed that it would have been more economical, at certain discount rates, for GSA to have constructed the buildings For example, leasing costs would exceed Federal construction and ownership costs by about $20 3 million using the present-value method, a discount rate of 6 percent, and a lease term of 20 years However, if a discount rate of 10 percent were used and if all other factors were equal, Federal construction and ownership costs would exceed leasing costs by about $30 5 million

Several methods--such as the present-value, rate-of-return, and accumulated-interest methods--can be used in comparing the costs of leasing and Federal construction over the estimated lives of the buildings The present-value method, which we used, is the method most often recommended by economists and systems analysts for use in evaluating alternatives that differ in the timing of cash flows The present-value method identifies the alternative (lease or construction) that incurs the lesser costs in terms of the present value of the future fund (normally cash) flows In effect, this method takes into account the timing of future Federal outlays over the term of the lease or the life of the asset when lease and construction alternatives are being evaluated

A major problem in the use of the present-value method has been the selection of the appropriate discount rate For Federal Government program analyses and decisionmaking, arguments have been presented for rates ranging from as low as the interest rate for borrowing by the Treasury to as high as certain rates of return that can be earned in the private sector of the economy Because the discount rate used has a direct effect on the results and conclusions of a lease-construction study, the choice of a rate is more than academic

GSA has used various discount rates, ranging from 4-1/2 to 12 percent, in its present-value analyses for comparing lease and construction alternatives The Office of Management and Budget instructed GSA by letter dated June 19, 1971, to use discount rates of 8 to 12 percent in future prospectus proposals submitted to the Office of Management and Budget and the Congress for lease construction and Federal construction projects According to instructions issued by the Office of Management and Budget, in June 1972, a 7-percent discount rate will be applied to future cost comparisons Leasing costs, however, will be reduced by 2 2 percent a year (average annual rate of inflation) before application of the 7-percent discount rate which in effect will result in about a 9-percent discount rate

Our comparisons were based, except where noted, on the method of analysis GSA had used in developing prospectuses for proposed lease construction and Federal construction projects, which were submitted to the Congress and the Office of Management and Budget Our comparisons were made for 10 long-term leases using 20- and 30-year periods--20 years is the maximum term for which GSA is legally permitted to lease buildings and 30 years is the maximum term permitted to acquire buildings through lease-purchase arrangements--and using discount rates of 6, 8, and 10 percent for converting future costs and receipts to present value We did not make a comparison for the 11th building because it was leased for a 5-year term

The results of our comparisons are summarized in the following tables

Present-Value Analysis of Federal Construction Compared with Leasing for 10 Buildings (20-Year Lease)

	Leasing costs		Construction and ownership costs		
	Total	Present value	Total	Present value	Difference
At 6-percent discount rate					
Lease payments	$285,164,340	$163,411,641	$ -	$ -	
Land cost	-	-	16,103,000	16,103,000	
Building cost	-	-	127,797,000	127,797,000	
Repair and improvement	-	-	20,480,520	9,219,566	
Real estate tax	-	-	43,704,480	25,064,520	
Residual value (building and land)	-	-	112,384,739	-35,041,559	
Total		$163,411,641		$143,142,527	$20,269,114
At 8-percent discount rate					
Lease payments	$285,164,340	$139,870,143	$ -	$ -	
Land cost	-	-	16,103,000	16,103,000	
Building cost	-	-	127,797,000	127,797,000	
Repair and improvement	-	-	20,480,520	7,348,486	
Real estate tax	-	-	43,704,480	21,458,899	
Residual value (building and land)	-	-	112,384,739	-24,106,527	
Total		$139,870,143		$148,600,858	-$ 8,730,715
At 10-percent discount rate					
Lease payments	$285,164,340	$121,195,683	$ -	$ -	
Land cost	-	-	16,103,000	16,103,000	
Building cost	-	-	127,797,000	127,797,000	
Repair and improvement	-	-	20,480,520	5,935,209	
Real estate tax	-	-	43,704,480	18,596,255	
Residual value (building and land)	-	-	112,384,739	-16,700,372	
Total		$121,195,683		$151,731,092	-$30,535,409

Present-Value Analysis of Federal Construction Compared with Leasing for 10 Buildings (30-Year Lease)

	Leasing costs		Construction and ownership costs		
	Total	Present value	Total	Present value	Difference
At 6-percent discount rate					
Lease payments	$427,947,770	$196,109,046	$ -	$ -	
Land cost	-	-	16,103,000	16,103,000	
Building cost	-	-	127,797,000	127,797,000	
Repair and improvement	-	-	46,081,170	14,286,520	
Real estate tax	-	-	65,556,720	30,068,683	
Residual value (building and land)	-	-	101,576,271	-17,684,429	
Total		$196,109,046		$170,570,774	$25,538,272
At 8-percent discount rate					
Lease payments	$427,947,770	$160,430,955	$ -	$ -	
Land cost	-	-	16,103,000	16,103,000	
Building cost	-	-	127,797,000	127,797,000	
Repair and improvement	-	-	46,081,170	10,516,462	
Real estate tax	-	-	65,556,720	24,605,622	
Residual value (building and land)	-	-	101,576,271	-10,096,681	
Total		$160,430,955		$168,925,403	$-8,494,448
At 10-percent discount rate					
Lease payments	$427,947,770	$134,319,987	$ -	$ -	
Land cost	-	-	16,103,000	16,103,000	
Building cost	-	-	127,797,000	127,797,000	
Repair and improvement	-	-	46,081,170	7,938,543	
Real estate tax	-	-	65,556,720	20,606,662	
Residual value (building and land)	-	-	101,576,271	-5,820,320	
Total		$134,319,987		$166,624,885	-$32,304,898

Following are explanations and reasons for certain amounts used in the preceding cost comparisons.

Leasing costs are total rentals under the lease agreements, exclusive of the estimated cost of lessor-furnished services and utilities, where applicable. The amounts for the Government's construction and ownership costs for land, building, and real estate taxes were obtained from GSA appraisal reports. Before awarding the leases, GSA estimated (1) the fair market value of the land on the basis of comparable land sales, (2) the reproduction costs of the buildings on the basis of building plans and specifications, and (3) real estate taxes on the basis of current assessments and tax rates.

Property owned by the Federal Government is not subject to State and local real estate taxes. In making cost comparisons, in accordance with Office of Management and Budget policy, GSA recognizes, as a cost of Government ownership, real estate taxes which are foregone by States and localities when the Government constructs buildings. In our analyses we have considered real estate taxes as part of the Government ownership costs.

Repair and improvement costs were based on GSA's estimate that Federal buildings from 1 to 10 years old required an annual average of $0.12 a square foot for repair and improvement, from 11 to 20 years, $0.36, from 21 to 40 years, $0.60, and from 41 to 50 years, $1.20.

Residual values were computed in accordance with the method prescribed by the Office of Management and Budget in June 1972 that will be used in future cost comparisons contained in prospectuses to be submitted to the Congress. Under this method the values of the building sites (land) were increased by 1.5 percent for each year and the values of the buildings were decreased by an obsolescence and decay factor of 1.7 percent for each year.

The comparisons show that Federal construction becomes more economically advantageous as the discount rate decreases and as the lease term increases. Leasing is more economically advantageous as the discount rate increases and as the lease term decreases When the 10 buildings are considered collectively, construction is the most economical alternative at a 6-percent discount rate, whereas leasing is the most economical alternative at a 10-percent discount rate. These statements are also generally true when considering the 10 buildings individually

	Construction less costly		Leasing less costly	
	Number of buildings	Savings (millions)	Number of buildings	Savings (millions)
20-year lease term				
6-percent discount rate	9	$21.26	1	$ .99
8-percent discount rate	3	4.08	7	12.81
10-percent discount rate	2	.96	8	31.49
30-year lease term				
6-percent discount rate	9	26.58	1	1.04
8-percent discount rate	4	4.92	6	13.42
10-percent discount rate	2	1.13	8	33.43

Although Federal construction entails large initial expenditures, total GSA fund requirements would be substantially less than the total lease payments made during the period of a lease contract Total outlays by GSA for leasing the 10 buildings would exceed construction outlays by about $121 million for a 20-year lease period and by about $238 million for a 30-year lease period

GSA did not make an analysis to determine whether it would have been more economical to lease or to construct the 10 buildings GSA officials informed us that Federal construction of the buildings was not considered when the decision was made to lease the buildings because many people had to be moved into the space within a short period of time The officials stated that the space requirements could be met only by the leasing of buildings

Funding of GSA construction

On April 30, 1959, the Administrator of General Services testified on proposed legislation (later enacted as the Public Buildings Act of 1959) before the Subcommittee on Public Buildings and Grounds of the House Committee on Public Works The Administrator stated that, to meet growing space needs, from $1-3/4 billion to $2 billion, or approximately $350 million a year, would have to be appropriated for construction during the 1960-65 period After enactment of the Public Buildings Act of 1959 (40 U S C 601), GSA's appropriations for Federal construction for fiscal years 1959 through 1972 totaled approximately $1 7 billion, an average of $122 million a year The Congress not only has approved GSA's budget requests but, in some years, has suggested that they be increased

On July 18, 1968, the GSA Deputy Administrator testified at hearings before a subcommittee of the Senate Public Works Committee on a bill (S. 3706) to amend the Public Buildings Act of 1959 that would provide for, among other things, a revised method of financing the construction and alteration of public buildings The Deputy Administrator stated that, historically, the level of GSA's public buildings construction program had suffered from increasing competition with other Federal programs for available budget dollars. He stated also that, due to the wide fluctuations and low funding levels of GSA's construction program, GSA had been unable to carry out an effective program to meet Federal office space needs through the construction of Government-owned buildings

Public Law 92-313, approved June 16, 1972, changed the method of funding construction and operating costs associated with meeting the space needs of the Government Agencies will be required to pay rent to GSA at commercial rates for space occupied GSA will use the resultant receipts to finance its public building operating costs and capital improvements--land acquisition, design, construction, repair, and improvements

GSA officials advised us that rent based on commercial rates would produce an estimated annual income of from $760 million to $800 million GSA estimated, on the basis of fiscal year 1970 costs, that this income would be sufficient to finance operating costs and also would provide from $317 million to $340 million a year for capital improvements--almost double the average annual amount appropriated for capital projects in the 5-year period ended June 30, 1971

Public Law 92-313 also authorizes GSA to enter into lease-purchase arrangements for projects previously approved for construction by the Public Works Committees if no substantial change in the scope of the projects had occurred Under a lease-purchase arrangement, title to the property rests with the Government at the end of the lease period In January 1972 there were 63 approved projects, having a total estimated cost of about $747 million, that could be constructed under lease-purchase arrangements

C On April 14, 1972, the House Committee on Public Works, H201 in a report on a bill (later enacted as Public Law 92-313) to amend the Public Buildings Act of 1959, as amended, stated that direct Federal construction was the most efficient and economical means of meeting Government building needs The Committee stated also that the futility of seeking $1 billion for direct Federal construction of the present backlog of 63 buildings in competition with the present spending priorities, together with the urgency of the need for these facilities, made it clear that the best course was to permit GSA to construct the presently authorized buildings, under lease-purchase arrangements, over a relatively short term and then to return to direct Federal construction through the public buildings fund authorized in the bill

At various times GSA, using the present-value approach, prepared cost analyses of construction and leasing alternatives for 22 of the 63 approved projects

GSA's analyses of 16 projects, using a 4-1/2-percent discount rate, showed that the total present-value leasing costs of $366 million would exceed the present-value construction costs, excluding imputed real estate taxes and residual values of the buildings and sites, by $51 million But, if a 6-percent discount rate were used in the analyses and all other factors were equal, the difference would be reduced to $7 million

GSA's analyses of the other six projects, using a 6-percent discount rate, showed that present-value leasing costs would exceed present-value construction costs, including imputed real estate taxes and residual values of the buildings and sites, by $65 million But, if a 4-1/2-percent discount rate were used in the analyses and all other factors were equal, the difference would be increased to $203 million

We did not request the formal views of GSA on the contents of this report We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

The Honorable William Proxmire
United States Senate