APPENDIX F:

Determination of Operating or Capital Lease Classification for Budget Scoring

1. General

a. Requirement

This policy, issued jointly by the Assistant Commissioners for the Offices of Real Property Asset Management and Real Estate Acquisition, provides policies for determining appropriate budget scoring treatment, either as an operating or capital lease, for every real property lease transaction, as required by Office of Management and Budget (OMB) Circular No. A-11, Appendix B.

Asset Managers, in coordination with the Leasing Specialist, must undertake all lease scoring evaluations and determine whether a lease should be treated as an operating lease (annual operating expense) or capital asset lease (capital acquisition) for budget scorekeeping purposes.

b. Impact

Agencies must differentiate between operating and capital leases for purposes of budget scoring per the Budget Enforcement Act of 1990 (Title XIII of the Omnibus Reconciliation Act of 1990), known as the BEA. The budgetary and accounting consequences of entering into a capital lease are serious and can significantly affect GSA's rental of space budget. If a lease is a capital lease, GSA must allocate budget authority in the initial year of the lease that equals the present value of the triple net lease payments plus the cost of the associated annual real estate taxes over the full term of the lease.

c. Applicability

This policy applies to all lease actions.

2. Background

The BEA, as revised by the Balanced Budget Act of 1997, deals with assigning budget authority.

Appendix A, Scorekeeping Guidelines, and Appendix B, Budgetary Treatment of Lease-Purchases and Leases of Capital Assets, of Circular No. A-11 give instructions for scoring lease transactions.

OMB Circular No. A-94, Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs, Appendix C, Discount Rates for Cost-Effectiveness, Lease-Purchase, and Related Analyses, is updated annually with the President's budget submission to Congress and provides the discount rates to be used in all 90 percent scoring calculations for the year.

On March 31, 2006, the GSA Inspector General reported that lease scoring was not being performed in accordance with prescribed policy and concluded, "It is imperative that PBS associates adhere to all scoring guidelines and appropriately test all scoring scenarios."[1]

3. Explanation of Changes

Every lease action must be evaluated against the criteria detailed in OMB Circular No. A-11, Appendix B, to determine whether it is an operating or capital lease. This Desk Guide policy addresses the lease scenarios where GSA may make a determination of operating lease status without undertaking the 90 percent scoring calculation. When a 90 percent scoring calculation is required, this policy identifies the stages of a project where a 90 percent scoring calculation is required, the time frame for the determination, and the roles and responsibilities for performing the evaluation.

4. Instructions and Procedures

a. Timely Determination

For **all** lease actions, Asset Managers, in coordination with the Leasing Specialist, must make the determination that a lease is either an operating or capital lease. The project schedule must incorporate sufficient time to complete this determination. A determination of the lease classification as operating or capital—regardless of whether it is an interim or final determination—must be provided to the Leasing Specialist no later than 2 business days from the date of request for lease transactions below the statutory prospectus level, and no later than 10 business days from the date of request for lease transactions that are equal to or exceed the statutory prospectus level.

b. Use of Lease Scorekeeping Classification Workbook

The Asset Manager and Leasing Specialist must use either the memoranda or the worksheets included in the Lease Scorekeeping Classification Workbook to provide a determination of operating or capital lease treatment for each proposed lease action before a lease award is made.

c. Use of Circular No. A-11

The Regional Director of Portfolio Management or his or her designee must follow the current OMB guidelines in Circular No. A-11, Appendices A and B, and use the current OMB discount rates provided in Circular No. A-94 Appendix C, when making the determination of lease treatment for budget scorekeeping purposes. The most current version of Circular No. A-11, Appendices A and B, and Circular No. A-94, Appendix C, can be found at: OMB Circular A-11 and OMB Circular A-11 Appendix C

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[1] Audit of PBS's Tenant Improvement Process (GSA Inspector General, Report Number A050063/P/R/R06005, March 31, 2006).

d. Operating Lease Criteria

Appendix B to Circular No. A-11 lists multiple criteria that a lease must meet to be considered an operating lease. If any one of these criteria is not met, the lease will risk being scored as a capital lease. **Every** leasing transaction must be evaluated against these criteria to distinguish capital leases from operating leases. If Circular No. A-11 is updated or modified, the leasing transaction must be evaluated using the most recent criteria and guidelines. The criteria to be applied are as follows:

- 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 period.
- 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 the unique specification of the Government as lessee.
- There is a private-sector market for the asset.
- The project is not constructed on Government land.
- There is no provision of Government financing and no explicit Government guarantee of third-party financing.
- Risk of ownership of the asset remains with the lessor unless the Government was at fault for such losses.
- The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value (FMV) of the asset at the inception of the lease.

e. The 90 Percent Criterion

To determine whether the 90 percent threshold has been reached or exceeded, the Asset Manager must conduct a 90 percent scoring calculation using the scoring worksheet found on the Office of Real Property Asset Management Web site at http://pbsportal.pbs.gsa.gov:7777/portal/page?_pageid=84,148370&_dad=portal&_schema=PORTAL.

While all lease transactions must be evaluated against the above operating lease criteria, in certain scenarios (as detailed below), the likelihood of the lease scoring as a capital lease is remote. In these situations, if the Leasing Specialist or Lease Contracting Officer and Asset Manager provide sufficient facts about the specific lease transaction to conclude reasonably that it will not score as a capital lease, the 90 percent calculation is not required to make such a determination.

The subsequent discussion in this policy groups leases according to the following scenarios, and describes the necessary evaluations by lease term, project phase, or both:

- Leases with a term of 5 years or less
- Leases with a term more than 5 and up to 20 years
- Prospectus-level leases
- Simplified leases
- Extensions
- Expansions
- Free space
- Options
- Unique agency-specific leases

5. Analysis Based on Term

Depending on the term of the lease, perform the determination of lease classification as follows.

a. Leases With a Term of 5 Years or Less

For leases with a term of 5 years or less (except proposed lease construction) with **proposed rental rates that are consistent with prevailing market rates for comparable facilities in the community in which the leasing action is to occur**, the Leasing Specialist can make the determination that the proposed lease is an operating lease by verifying that the lease meets the first 8 criteria in paragraph 4(d). The 90 percent calculation is not required.

Upon initial active status of a project in STAR, all applicable portions of the Determination of Operating Lease Classification must be completed, signed by the Lease Contracting Officer, scanned, and included in the lease project file before requesting the certification of funds and awarding the lease. If any changes to the term will yield a lease over 5 years, the Lease Contracting Officer must work with the Asset Manager to determine operating lease treatment as detailed in the following paragraphs.

b. Leases With a Term More Than 5 and up to 20 Years

For leases with a term more than 5 and up to 20 years, and for all potential lease construction leases regardless of term, the Leasing Specialist must work with the Asset Manager to make the determination that the proposed lease is an operating lease by certifying that the lease meets criteria 1 through 9 in paragraph 4(d), above, including the 90 percent calculation.

Upon initial active status of a project in STAR or REXUS or by an interim process before REXUS is active, Leasing Specialists must notify their respective Asset Manager of the proposed lease and provide the following information:

- Proposed ANSI/BOMA Office Area (ABOA) square feet (SF)
- Proposed total rentable square feet (RSF)
- Proposed full-service rate with a breakout of operating costs, taxes, and insurance
- Proposed location or market
- Proposed parking
- Anticipated award and effective dates
- Proposed term

The Asset Manager must run an initial determination with this preliminary information, and will provide an initial determination of operating lease treatment if:

- The "score"—which is the net present value (NPV) of the minimum lease payments—is less than 80 percent of the fair market value (FMV) of the construction (see paragraph 8(a), below, regarding how to develop the input values for this calculation); and
- The proposed lease also meets the first eight criteria in paragraph 4(d).

The Leasing Specialist will not have to request a final scoring analysis until the pre-award phase, unless the ABOA SF requested by the client agency or the full-service rate increases. If these factors increase throughout the lease process, the Leasing Specialist must resubmit the initial determination request with revised the space or rate information.

A final Determination of Operating Lease Treatment form must be prepared before award to the apparent successful offeror. Accordingly, the proposed lease must be evaluated to determine operating or capital lease treatment. The Leasing Specialist must request this determination by completing the final Determination of Operating Lease Treatment form and submitting it to the Asset Manager for review. The Asset Manager will return the completed form and all supporting documentation—the General Construction Cost Review Guide (GCCRG) and Lookup Table—to the Leasing Specialist. A signed copy of the Final Determination of Operating Lease Treatment form must be uploaded into eLease and provided to the budget activity (BA) 53 Budget Analyst at the time of the request for certification of funds.

6. Analysis Based on Other Lease Types and Actions

Observe the following guidelines when dealing with special leasing actions such as prospectus-level leases, simplified leases, extensions, expansions, free space, options, and unique agency-specific leases.

a. Prospectus-Level Leases

All prospectus-level leases with terms of more than 5 years require a determination of operating lease status taking into consideration all nine criteria in paragraph 4(d), above, including the 90 percent scoring calculation—

1. At the initial active project phase,

2. At the time of the submission of the project to Central Office, and

3. After receipt of authorization of the project, but before award, using the apparent successful offeror's final offer and the latest discount rates.

b. Simplified Leases

If a lease qualifies as a simplified lease, the Lease Contracting Officer must confirm its operating lease status by signing the Simplified Lease Scoring Memorandum, which states that all applicable conditions have been met to qualify as an operating lease. No further action on the determination of operating lease status is required. The Leasing Specialist must provide a copy of the signed memorandum to the BA 53 budget analyst, along with the request for the certification of funds.

c. Extensions

If the Government seeks to extend a lease for a temporary term (generally 1 to 3 years, not to exceed 5 years), the Leasing Specialist is authorized to make the determination that the proposed lease is an operating lease by certifying that the lease meets the criteria in paragraph 4(d) of this policy. The 90 percent scoring calculation is not required for the determination. The Leasing Specialist must complete the Determination of Operating Lease Classification for Leases 5 Years or Less, per paragraph 5(a) of this policy, and include a copy in the lease project file. No further action with regard to lease classification for budget scorekeeping purposes is required.

d. Expansions, Succeeding, and Superseding

If a client agency requests expansion space for a location already under lease to the Government, before committing to any expansion space, the Leasing Specialist and Asset Manager must take into consideration the materiality and time frames involved to determine the impacts on the status of the lease as an operating lease and on the prospectus threshold. The key to determining the next step is to define whether the changes to the lease were foreseen before lease award or were truly independent leasing actions raised by the client agency after initial lease award. The Leasing Specialist or Lease Contracting Officer must document the lease file for any action taken and follow the processes described in paragraph 5 as applicable for the lease term.

If all of the space under an existing lease plus the expansion space is to be satisfied with either a succeeding or superseding lease, then the total space included in the lease proposal must be considered when comparing the lease value to the prospectus threshold and undertaking a scoring calculation. The Leasing Specialist or Lease Contracting Officer must document the lease file for any action taken and follow the processes described in paragraph 5 as applicable for the lease term.

e. Free Space

When an offeror proposes to provide, at no additional charge to the Government, a contiguous block of space that exceeds the maximum amount GSA has solicited, and the agency agrees to accept the extra space, the free space square footage is not added to the solicited square footage of the lease for purposes of the 90 percent scoring calculation.

f. Options

If a lease agreement contains an option to renew that can be exercised without further congressional action, it is presumed that the option will be exercised.

For example, if an approved prospectus stipulates a term of 20 years and the proposed lease deal is structured as 10 years firm with two 5-year options, the 90 percent scoring calculation must reflect a 20-year lease term.

However, if a lease has an approved prospectus for a term of 10 years, but the lessor offers a 10-year firm lease with two 5-year options, the 90 percent scoring calculation only needs to reflect a 10-year lease term. The two 5-year options cannot be exercised without a new prospectus, assuming that they are above the prospectus threshold, and therefore do not need to be calculated at the time of the analysis.

All options that are included in the lease agreement for leases below the statutory prospectus level that do not require prospectus approval to exercise must be included in the lease term for purposes of the 90 percent scoring calculation. If such options are not factored into the base lease's original 90 percent scoring calculation, the scoring requirements as defined in this policy must be applied before an option can be exercised.

g. Unique Agency-Specific Leases

Confirming operating lease treatment is difficult with respect to some of our client agencies. For example, for agencies such as the Transportation Security Administration (TSA), it is difficult to numerically score the project, as the rent charged bears no relationship to the construction cost of the space the agency would occupy. The Leasing Specialist and Asset Manager must determine whether the rent proposed for TSA space at an airport is reasonable compared to other rents charged at airports. If other office tenants within the airport are paying similar rental rates, the determination that the lease is an operating lease can be made without further action. The Leasing Specialist and Asset Manager should complete the Determination of Operating Lease Treatment for Unique Agency Leases form.

7. NPV/FMV Above 80 percent

Final scoring calculations yielding a NPV/FMV ratio above 80 percent are sufficiently high to be cause for concern. The Asset Manager must complete the scoring workbook and have the signed concurrence of the Regional Director of Portfolio Management. This concurrence may not be delegated.

8. Calculations

Instructions for performing the 90 percent scoring calculation are provided by the Office of Real Property Asset Management on the following Web site:

http://pbsportal.pbs.gsa.gov:7777/portal/page?_pageid=84,120677&_dad=portal&_schema=PORTAL.

a. Developing Inputs

For all 90 percent scoring calculations, the Asset Manager must develop inputs for the scoring worksheet using the most current GCCRG or data taken from a current market appraisal, if available.

If using the GCCRG, the Asset Manager must enter the total project Estimated Construction Cost (ECC) into the most current Lookup Table to determine the design and management and inspection fees applicable to the proposed action.

To determine FMV, the Asset Manager must add the total ECC to the design and management and inspection costs, and to the site acquisition costs. The value for land must be provided by the employees responsible according to regional policy or practice and can be determined through:

- Site comparables based on recent sales;
- Market values if developed for the geographic area based on land values per Floor Area Ratio (FAR) foot; or
- Any other suitable method, as long as the Asset Manager provides sufficient documentation.

b. Discount and Inflation Rates

Every time the 90 percent scoring calculation is performed, the Asset Manager must use the discount and inflation rates that are included in the President's most recent budget document. These rates are posted on the Portfolio Management Web site shortly after the President's budget is released. These are normally updated in December or January each year. Rates for 2010, which are based on the economic assumptions for the 2011 budget, can be found at OMB Circular A-11 and OMB Circular A-11 Appendix C.