WHITE PAPER

The Crisis in the Federal Government’s Infrastructure
Additional Approaches to the
Current Federal Budgetary Scoring Regime

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Executive Summary

On September 25, 2008, the Privatization, Outsourcing, and Financing Transactions Committee (the “Committee”) published a white paper regarding the effect of the federal budget scoring rules—under Office of Management and Budget (“OMB”) Circular A-11, Appendices A and B (“OMB A-11”)—on the ongoing infrastructure crisis. Through that white paper, prepared with input from the public and private sectors, the Committee “explain[ed] the federal budgetary scorekeeping rules, provide[d] the public and private sectors’ view of these rules, and discusse[d] potential legislative and regulatory alternatives that may enhance the Federal Government’s ability to efficiently and cost-effectively fund important infrastructure and other capital-intensive projects.” The ultimate purpose of the white paper was to facilitate a public discussion about these matters.

In this update to the 2008 white paper, the Committee identifies two additional, alternative scoring approaches that may more accurately reflect the government’s obligations in connection with long term capital and real property projects, including those undertaken through Public-Private Partnerships (“P3s”). Importantly, neither proposed option requires the government to surrender the transparency benefits provided by the current rules. In addition, neither option requires Congressional action, as each could be undertaken by Executive action.

First Alternative Approach: OMB would adopt a modified-version of the budget scoring rules currently used for federal credit programs under the Federal Credit Reform Act of 1990 (“FCRA”). Under this method, OMB would score the net present value of project costs, as adjusted for the amount of project risk taken by the government. For a project to move forward, an agency would require sufficient budgetary authority in the first year to obligate the risk-adjusted cost of the project. Such an approach could provide more opportunities for agencies to consider beneficial projects in which the majority of risk is carried by the private partner while allowing the government to track and account for the full cost of the project.

Second Alternative Approach: OMB would recognize new “safe harbors,” akin to those currently in place for Energy Savings Performance Contracts (“ESPCs”) and Utility Energy Service Contracts (“UESCs”), which would allow certain projects to be scored on an annual basis, thereby avoiding upfront capital investment scores that might prevent agencies from moving forward with transactions. Like the ESPC/UESC “safe harbors” currently in place, new “safe harbors” could be implemented to cover projects where the government’s contracting partner would carry most or substantially all of the project risk and cost savings would be achieved over time.

3 Id. at 2.
I. Introduction To Budgetary Scoring

“Scoring” is the process of measuring the budget effects of legislation, proposed contracts and other projected expenditures in terms of budget authority. To accomplish this, the U.S. House and Senate Budget Committees, the Congressional Budget Office (“CBO”), and OMB, collectively referred to as the “scorekeepers,” make use of “scorekeeping guidelines” which contain the concepts and principles to be used when evaluating obligations. When CBO looks at the cost of a piece of legislation, this is referred to as legislative scoring. When OMB or CBO look at a particular transaction, this is referred to as budgetary scoring.

The ability of a government agency to engage in a long-term capital or real property project that will involve the participation of private capital is impacted by the OMB A-11 scorekeeping rules (adopted in 1991). Unless an exception exists, these rules generally require that the entire amount of a long-term obligation be scored upfront in fiscal year 1, instead of spreading the obligation over each year of the project. One exception is for long-term transactions funded through the General Services Administration’s “Federal Buildings Fund” that are characterized as operating leases. Under the Federal Buildings Fund operating lease exception, lease payments due in each year during the lease term are scored only in that year and not upfront. However, achieving “operating lease” status for a Federal Buildings Fund project can be difficult under OMB A-11’s rules.

For projects that are not Federal Buildings Fund operating leases, it often is difficult for an agency to fit the entirety of a long-term obligation into its budgetary authority for the first fiscal year. A large score in the first year may eliminate budgetary authority the agency needs for other purposes it has planned for that year. As a result, potentially promising projects may never receive consideration, and agencies are prevented from undertaking long-term capital projects with private sector participation that could provide significant economic benefits to the government.

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5 See OMB A-11, Appendix B, at B1-B2 (identifying the “types of leasing and other nonroutine financing proposals” that must be submitted to OMB for a scoring review).
6 See id. at B2-B3 (discussing the definitions of lease purchases, capital and operating leases and the specific amounts that must be scored). See also OMB A-11, Appendix A, at A2-A3.
9 For a transaction to qualify as an operating lease under OMB A-11, Appendix B, an agency must satisfy certain criteria borrowed almost verbatim from Financial Accounting Standards Board Statement No. 13 (“FASB 13”), which is a system of accounting rules promulgated to assist with the reporting of leases by private-sector companies. A project must satisfy “all the criteria listed” in Appendix B to be characterized as an operating lease. Id. at B6 (emphasis added).
10 This white paper is not advocating that the government only should undertake long-term capital projects that involve the participation of private capital or that all P3s will lead to positive outcomes. There is no “one size fits all” approach to addressing the government’s public infrastructure needs. Rather, the purpose of this white paper is to identify and discuss additional alternative approaches to the current budget scoring regime to facilitate a (continued…)
The current status of the Department of Transportation (“DOT”) headquarters in the Navy Yard neighborhood in Washington, D.C. could be seen as one example of the unintended impact of these scoring rules. Under OMB A-11’s scoring rules, to maintain operating lease status and achieve favorable budget scoring, the term of the lease had to be less than 75% of the estimated economic life of the building, the net present value of the lease payments could not exceed 90% of the building’s fair market value at the beginning of the lease term, and there could not be a “bargain-price purchase option.” As a result, DOT entered into a 15-year lease with options to renew at then current rates or a purchase option at fair market value. The renewal and purchase options come up in 2021 at which point lease rates for similar property in the developing area will undoubtedly be higher and the property’s fair market value will reflect the increasing desirability of the area. Had the scoring rules not incentivized DOT to structure an operating lease, DOT might have negotiated a longer-term lease without a renewal option that increases rental rates to the current market and even achieved ownership at a bargain purchase price.

This update proposes two new (alternative) approaches that “may enhance the Federal Government’s ability to efficiently and cost-effectively fund important infrastructure and other capital-intensive projects,” while maintaining the government’s ability to accurately disclose and account for its total obligations.

Importantly, by adopting either alternative approach, the government would not be entering into unknown territory. The government has previously made use of alternative methods of scoring to advance important projects. For example, in 1996, Congress authorized funding for the Military Housing Privatization Initiative (“MHPI”), a pilot program designed to encourage privately-funded development of housing for the military. In guidance initially issued in 1997, OMB adopted several alternative scoring criteria for these projects, including the FCRA method of scoring loans and loan guarantees made to private contractors based on the government’s “degree of exposure,” or the statistical probability that a default on the project by the private contractor would have a financial impact on the federal deficit. Military bases throughout the country took advantage of these scoring rules, and were able to partner with private entities to build new housing for members of the armed services and their families.

discussion about whether these approaches could enhance the government's ability to consider undertaking a long-term capital or real property project that will involve the participation of private capital.

11 The DOT headquarters was an anchor project to promote redevelopment in the Navy Yard area of Washington, DC. As a result of this project, other development has occurred and property values have jumped.


14 OMB’s special scoring rules for MHPI projects expired in 2014, and these projects are now required to be scored at 100 percent in the year of authorization. Prior to this change in scoring, the MHPI was a popular program—projects begun in 1996 and 1999 included more than 3,600 housing units, and this number more than doubled in the (continued…)}
Joseph Sikes, the former director of the Department of Defense’s Housing Revitalization Support Office (“HRSO”), has stated that the use of alternative scoring guidelines for MHPI projects is what “enabled the privatization program to proceed.”\(^{15}\)

**II. Additional Approaches to Address Unintended Consequences To Budget Scoring**

**A. Alternative Approach One: FCRA-Type Scoring**

One potential option for addressing some of the unintended consequences resulting from the current scoring rules would be to borrow the procedures currently used to measure the costs of federal credit programs under the FCRA.

Prior to passage of the FCRA, federal loans were budgeted and accounted for on a cash basis—every dollar flowing in and out of the Treasury was budgeted for. This method of accounting did not accurately portray the costs of government lending: the costs of loans made directly to entities were overstated due to a failure to recognize that these costs would be offset with borrower repayments, and the costs of the government’s guarantees of loans were understated, because the guarantees would appear to have no cost in the year the guarantee was made, with no recognition that the government would incur costs in the case of a future default.

To remedy these problems, the FCRA implemented a new system of tracking the costs of the government’s lending. This method involves calculating the net present value of cash flows over a loan’s life cycle—this net value is referred to as the loan’s “subsidy cost.” For example, if the net present value of a direct loan’s outflows is $100, and the net present value of the loan’s inflows is $90, then the loan’s subsidy cost is $10. Under the FCRA, the budget authority required to make a loan is an amount equal to this subsidy cost—as this amount reflects the true cost of the government’s lending.\(^{16}\)

To calculate subsidy cost, an agency must first determine the value of the cash flows associated with its loans. This requires the agency to consider multiple factors—a lending agency will need to factor in how often payments are due, for example, and a loan guarantor will need to account for the percentage of the loan covered by the guarantee. The agency then needs to adjust the net value of its cash flows for risk of default. After risk adjustment, the cash flows are then discounted at the Treasury Rate to determine their present-day value.

\(^{15}\) Godfrey at 41.

\(^{16}\) The government retains “financing accounts,” which are used to track loan disbursements and repayments, as well as guarantee fee collections and default payments. See 2 U.S.C. § 661a(7). But, the transactions recorded in these accounts are not counted for purposes of calculating the budget deficit. See id. (“The term ‘financing account’ means the non-budget account or accounts associated with each credit program account which holds balances, receives the cost payment from the credit program account, and also includes all other cash flows to and from the Government resulting from direct loan obligations or loan guarantee commitments[.]”) (emphasis added).
To take a simple example, a government agency could make a $1000 loan that has a 10% chance of defaulting in year one. The estimated future cost of the loan in that year is therefore $100, or 10% of $1000. That amount then needs to be discounted by the Treasury rate to determine its present value. Assuming a Treasury rate of 6%, the net present value of that amount would be $94.34. As a result, the subsidy cost of guaranteeing the one-year $1000 loan is $94.34. Under the FCRA, the lending agency would require $94.34 in budget authority in year zero to guarantee the loan.

This same framework could be applied by OMB when scoring long-term capital or real property projects, including those accomplished as P3s. Under this approach, an agency would conduct a risk adjustment analysis to determine how much project risk lies with the government. The net present value of the risk-adjusted cost of the project, or “capital liability cost,” would be the amount scored by OMB in the first year of the project.

One consideration in determining the risk adjustment would be the possibility that the government would be required to assume a private partner’s payment obligations. OMB could also provide guidance on other risk factors an agency should consider, and could make use of the factors currently considered under OMB A-11. For example, OMB could instruct agencies to consider whether the project, if vacated by the government, could be repurposed for the government or sold to a commercial buyer. Such an approach would require agencies to develop the capability to assess the expense and risk involved in potential projects.

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17 Under the FCRA construct, OMB requires lending agencies to develop statistical models that are predictive of defaults to calculate the subsidy cost of loans and guarantees. OMB Circular No. A-129 at 6, available at https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/circulars/A129/a-129.pdf. The Federal Accounting Standards Advisory Board (“FASAB”) also provides guidance and criteria for estimating default risk. See FASAB Handbook of Accounting Standards and Other Pronouncements, as Amended, available at http://www.fasab.gov/accounting-standards; see also FASAB, Statement of Federal Financial Accounting Standards (“SFFAS”) No. 19, § 35 (“Each credit program should use a systematic methodology, such as an econometric model, to project default costs of each risk category.”), available at http://files.fasab.gov/pdffiles/handbook_sffas_19.pdf. Under FASAB guidance, federal agencies calculating default risk should consider the following: “(1) loan performance experience; (2) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans; (3) financial and other relevant characteristics of borrowers; (4) the value of collateral to loan balance; (5) changes in recoverable value of collateral; (6) newly developed events that would affect the loans' performance; and (7) improvements in methods to reestimate defaults.” SFFAS No. 19, § 34.

18 Present Value (“PV”) = Future Value divided by (1 + interest rate), or $100 ÷ 1.06.

19 To perform this analysis, federal agencies would need to develop the capability to estimate the risks associated with long-term capital projects in the same way that the government has developed the capability to estimate default risk under the FCRA.

20 In cases where agencies wanted to pursue a P3, OMB could also require agencies to conduct a “Value for Money” (“VfM”) analysis to determine whether the partnership resulted in savings for the government. Under a VfM analysis, the agency would calculate the costs of performing the project using only appropriated funds. This amount would then be compared to the costs of performing the project with private-financing. A fulsome VfM analysis would require agencies to consider a number of factors, such as the higher cost of borrowing in the private sector and also the potential that the private sector might incur construction or installation costs lower than those incurred during a typical government construction project. Agencies would pursue whichever option provided the best VfM. Regardless of the budget scoring methodology chosen, Alternative Approach One or Alternative (continued…)...
A further feature of a FCRA-based approach to scoring long-term capital and real property projects is the reassessment of risk for each year following the first year. As a project proceeds forward, project risk to the government could either increase or decrease based upon any number of factors. Consistent with FCRA, an annual assessment would be made of project risk and a score adjustment made to that agency’s project for that year in the amount of the difference between the previously assigned capital liability cost and the newly-assigned capital liability cost.\footnote{There would not be a score for that year of the entirety of the newly-recognized capital liability cost because that would multiply the obligation authority previously recognized and scored.} This annual scoring adjustment could either increase the score of the project in that later year or decrease it depending upon the reassessment of risk. It is likely that in most cases the risk recognized for a project would fall as initial unknowns become more certain over time.

A simple example of a long-term capital or real property project illustrates how this might work. Assume the government agrees to a P3 with a total cost of $1,000,000 that carries a 10% risk allocation to the government. That risk allocation could represent a 10% risk that the government would need to take over the private partner’s payment obligations, or it could include other factors, such as the demand risk associated with the completed project.\footnote{Several of the factors currently considered for operating lease treatment under OMB A-11 are targeted at minimizing the amount of “demand risk,” or the risk that there would be no commercial market for the asset once the government no longer needs it. These criteria include the requirement that the asset be a “general purpose asset rather than being for a special purpose of the Government” and the requirement that there be a “private market” for the asset. \textit{See} OMB A-11, Appendix B, at B7.} In any event, the capital liability cost of the project would be $100,000, or 10% of the project cost over time. This $100,000 capital liability cost, once brought to net present value, would be the amount scored by OMB in the first year. This would mirror the FCRA process, under which a lending agency would need the net present value of $100 in budget authority to make a $1,000 loan guarantee with a 10% risk of default. In subsequent years, the 10% risk initially assigned to the government leading to the capital liability cost scored in the first year would be reassessed and a score assigned in that later year in the amount of the difference between the original capital liability cost and the new capital liability cost, whether that be an add to the score or a decrease.

Currently, there are several projects that could be more likely to advance if OMB adopted the FCRA approach. For example, GSA’s decision to cancel a project to develop a new FBI headquarters drew considerable negative press attention in July 2017.\footnote{Jonathan O’Connell, et al, “Fallout From FBI Headquarters Decision Leaves Losers All Around,” Washington Post, available at https://www.washingtonpost.com/business/economy/fallout-from-fbi-headquarters-decision-leaves-losers-all-around/2017/07/11/7571b362-664a-11e7-8eb5-ecbccc2e7bfb_story.html?utm_term=.f7b78921f077.} FBI personnel are currently dispersed throughout the Washington, D.C. metro area, with many located in expensive leased office spaces and others located in the notoriously outdated J. Edgar Hoover Building in Approach Two, described \textit{infra}, or another approach, a VfM analysis could help to ensure that the government adopts an approach that is in its best interest when considering a P3 or an in-house approach.
Finding an economically viable approach to relocation was made that much more difficult under the current scoring rules.

From 2013 to 2017, and prior to cancelation, the GSA had proposed a swap in which the GSA would provide a developer with the Hoover Building, in exchange for the developer constructing a new FBI campus. The GSA proposed this swap in part because of the OMB scoring rules. At the outset of the project, GSA was unable to pursue a lease-leaseback arrangement, pursuant to which GSA would lease federal land to the developer in exchange for the developer leasing the completed FBI building back to the government, because OMB interpreted OMB A-11 as requiring that arrangement to be scored in its entirety upfront.

Adopting the FCRA approach, however, might allow the salutary aspects of an FBI headquarters type of project to be factored into its budget scoring. For example, if the government was to consider demand risk as part of its default risk calculation, it could assess the likelihood that the project owner would be required to take back the facility to accommodate some government need, e.g., a reconfiguration of government space or discontinuance of a government function, and this could help improve the project’s upfront budget score.

In conclusion, scoring long-term capital or real property projects in a manner akin to how the government treats credit programs under the FCRA would require agencies to consider numerous relevant risks before entering into projects. This system also would not be as rigid as the current “all or nothing” approach, by providing the scorekeepers flexibility to consider the government’s actual risk in a long-term capital project in which the private sector is a participant. Use of an FCRA model might also encourage good behavior in agencies, by incentivizing them to find long-term projects with low risks to the government.

Implementing a new system for determining budget authority would also not require the government to discard OMB A-11 in its entirety. Rather, the rules currently in place could be kept as a means of assuring that the government possesses a balance sheet that accurately reflects total obligations. This would be in keeping with the original purpose of FASB 13, which was promulgated to help companies determine how to record leases on their books. Setting up a separate system for identifying the totality of government obligations would keep this transparency in place.

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24 While reporting on the decision to cancel the headquarters, the Washington Post provided a summary of the unfortunately decayed state of the Hoover building: “The Hoover complex, completed in 1975 by President Gerald Ford, lacks required security setbacks from Pennsylvania Avenue. Netting hangs on the Ninth Street NW facade to prevent broken concrete from hitting passersby 160 feet down on the sidewalk below. Staff on the 10th floor sit in a space designed to house 35 million fingerprint cards, which were relocated to West Virginia in 1995.” See id.

B. Alternative Approach Two: Additional “Safe Harbors” To The Current Rules

Another option to alleviate the unintended consequences resulting from scoring rules would be to craft additional “safe harbors” for projects in which the private partner takes on the majority of the risk. The existing “safe harbors” for ESPCs and UESCs, as described in OMB Memorandums M-98-13 and M-12-21, are instructive.26

Under an ESPC, the private party takes on considerable risk by agreeing not to be paid if energy savings are not achieved:

- The energy-saving measures to be installed must “improve energy efficiency” to the extent that the total life-cycle cost of the building will be lower than under an alternative system. This is referred to as “life-cycle-cost effectiveness.”

- The private party installing the measures must guarantee that these savings (i.e., life cycle-cost effectiveness of the new measures) will cover the full cost of Federal investment for improvements.27

UESCs are similar, and concern contracts between Federal agencies and local utilities for improvements in energy, water, or sewage services. Under these contracts, the local utility guarantees that the savings created by the improvement will cover the full cost of the federal investment for the improvement.28

As a result of these savings, ESPCs and UESCs are scored and paid on an annual basis. In other words, OMB does not score the net present value of the government’s obligations under the contract “up front,” and instead scores an annual amount equal to the payment obligation under the contract each year. This is done without regard to the government’s retention of the relevant assets after the contract terminates which, under OMB A-11, would be fatal to annual scoring. In fact, an ESPC or UESC that includes “onsite energy generation” will be scored on an annual basis only if the federal government retains title to the installed capital goods at the conclusion of the contract.29

The general principle derived from the ESPC/UESC “safe harbor”—that a covered project’s budgetary score should reflect that the project’s upfront costs will be covered by future savings and that the private sector bears certain risks—could be applied to other areas.

For example, a “safe harbor” could be implemented for projects that engender savings by consolidating federal resources. Government employees in many agencies are currently

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27 OMB Mem. M-12-21 at 2–3.
28 Id. at 3-4.
29 Id. at 4.
dispersed inefficiently across multiple, expensive leased-office spaces. To increase collaboration and produce cost-saving efficiencies, P3s could be developed to renovate federally-owned buildings large enough to consolidate these employees in one place. Under these agreements—or "Space Savings Performance Contracts" ("SSPCs")—the private partner would front the cost of renovating the buildings, and the government would compensate the private partner using funds that it would have normally spent on the lease tenancies.

Like an ESPC, an SSPC would recognize that the government can incur considerable costs by doing "nothing"—it can incur high tenancy costs by dispersing its employees to a variety of locations, usually under short-term, expensive leases which must be renewed on a regular basis. Moreover, both concepts recognize that the cost of doing "something," such as installing a solar panel or renovating a central headquarters, can be covered with the savings achieved by moving away from a less efficient status quo ante.30

Finally, scoring under this approach results in different amounts being scored than under Alternative Approach One, discussed above. Under Alternative Approach One, OMB would score the net present value of the capital liability cost, a risk-based number, in the first year of a project. Under an ESPC-like approach, rather than scoring a capital amount upfront, OMB would score an annual amount each year, with that amount being equivalent to the cost of the contract in that year.

III. Conclusion

Although OMB A-11 serves an important interest in promoting transparency, OMB’s current scoring rules often hamper the ability of a government agency to engage in a long-term capital or real property project with the involvement of private capital. The two additional, alternative approaches of scoring proposed in this paper, along with the other approaches discussed in the 2008 white paper, might be considered to allow the government to move forward with worthy projects, while still accurately disclosing the costs of those projects. As the Committee stated before, this white paper “should be viewed as laying the foundation for understanding the nature of the problem, identifying potential alternatives and for galvanizing support from within the public and private sectors to work together to resolve the issues relating to this complex issue.”31

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30 Building-out “safe harbors” could encourage agencies to seek out areas where they are currently incurring significant costs as a result of a reluctance to act (or more likely an inability to act because of the current budget scoring rules). The agencies then could craft contracts designed to take advantage of the savings achieved as a result of acting. This in turn could result in considerable savings to the government, while maintaining in a separate “balance sheet” record the information required for the transparency provided by OMB A-11.

DISCLAIMER & ACKNOWLEDGMENTS

The Privatization, Outsourcing, and Financing Transactions Committee of the American Bar Association, Section of Public Contract Law is publishing this White Paper to facilitate public discussion of issues relevant to public contract law. The content of the document has not been approved by the Council of the Section of Public Contract Law, the ABA House of Delegates, or the ABA Board of Governors, and does not represent the position of the Committee, the Section, or the ABA.

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