



March 22, 2013

Honorable Jeff Miller
Chairman
Committee on Veterans' Affairs
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This letter responds to the request from you and Congressman Michaud for information about the Congressional Budget Office's (CBO's) budgetary treatment of major medical facility leases of the Department of Veterans Affairs (VA). In sum, CBO believes that most such leases are essentially purchases of facilities built specifically for VA's use, and therefore that the costs of acquiring them should be recorded in the budget when VA enters into the lease, rather than spread out over the duration of the lease.

VA's Leases of Major Medical Facilities

VA is authorized to lease medical facilities under current law, but must receive specific legislative authorization for leases with average annual rental payments in excess of \$1 million. The department requests authority for such leases in its annual budget submission, and the Congress provides such authority annually in authorization acts.¹

VA classifies its leases for major medical facilities as operating leases, and therefore records the resulting obligations (that is, legally binding commitments that will result in outlays) on an annual basis in an amount equal to the lease payments due in that year.² Prior to 2012, CBO followed that treatment in estimating the cost of legislation that would authorize

1. The VA Major Construction Authorization and Expiring Authorities Extension Act of 2012 (Public Law 112-191), which was signed into law on October 5, 2012, did not provide authority for any leases of major medical facilities.

2. For further information on the budgetary treatment of operating leases, see the Office of Management and Budget's Circular A-11, *Preparation, Submission, and Execution of the Budget*, Appendix B.

those leases on the assumption that all of the leases were short-term contracts for the use of existing facilities, or renewals of leases on facilities currently used by VA.

However, while preparing a cost estimate for the introduced version of H.R. 6375, the VA Major Construction Authorization and Expiring Authorities Extension Act of 2012, CBO received additional information from VA regarding the department's practices in contracting and executing most of the existing leases. Specifically, it became clear that, although some leases for major medical facilities are short-term contracts, most such projects authorized over the past several years were newly constructed facilities that were built to the department's specifications and are leased for lengthy terms (15 to 20 years). Most of the VA leases have many of the following key features:

- The facilities are constructed at the request of the federal government;
- The facilities are constructed to the unique specifications of the government;
- The leases on the newly constructed facilities are long-term—usually 20 years;
- Typically, VA's lease payments are the only or primary source of income for the facilities;
- The term of VA's lease coincides with the term of the lessor's financing instrument for developing and constructing the facility (that is, a facility financed with a 20-year bond will have a 20-year lease term);
- VA commits to make fixed annual payments that are sufficient to service the debt incurred to develop and construct the facility, regardless of whether the agency continues to occupy the facility during the guaranteed term of the lease; and
- The fixed payments over the life of the lease are sufficient to retire the debt for the facility.

Budgetary Treatment of VA's Leases

In estimating the impact of authorizing legislation, CBO would treat leases for existing medical facilities under short-term contracts as operating leases, showing budget authority and outlays on an annual basis. However, based on VA's practices over a number of years, CBO concluded that the

majority of the leases proposed in 2013 did not qualify for treatment as operating leases.

CBO believes, rather, that critical features of those long-term leases are similar to contracts for acquiring facilities and thus a form of third-party financing, an arrangement in which a federal agency obtains a capital asset using funds raised by a nonfederal entity.³ Whereas entering into an operating lease is similar to renting an apartment—a renter can move out after a short period with no further commitment—VA’s build-to-lease contracts are similar to obtaining a mortgage to buy a house; through the agreement, the agency acquires an asset along with a corresponding liability to pay for the asset over time. Because those arrangements are equivalent to a government purchase of the asset, financed by borrowing by the lessor on behalf of the government, their cost should be recorded up front in the federal budget when VA enters into the lease, like other expenditures that are financed by federal borrowing: The cost of the activity is recorded in the budget when it occurs, not when the debt is repaid. That treatment is consistent with CBO’s long-established practice of estimating upfront costs for legislation affecting other, comparable authorities, such as enhanced-use leases and the Department of Defense’s build-to-lease contracts for overseas housing.⁴

Third-party financing for federal facilities and other assets is more expensive than traditional acquisition methods because the third party borrows funds at interest rates higher than Treasury rates. In the case of VA leases, the cost premium is even greater because the agency loses the residual value of a building that it has fully or mostly paid for when it vacates the facility at the end of the lease term.

CBO’s Cost Estimates

CBO provides cost estimates for legislation under consideration by the Congress. (Generally, most such formal cost estimates are completed for legislation approved by authorizing committees, prior to floor consideration in the House or Senate.) Those estimates reflect CBO’s best judgment as to

3. For more information on the budgetary treatment of third-party financing, see Congressional Budget Office, *Third-Party Financing of Federal Projects*, Issue Brief (June, 2005)
http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/63xx/doc6399/06-01-thirdpartyfinancing_brief.pdf.

4. See the discussion on enhanced-use leases in the Congressional Budget Office, cost estimate for [S. 1042, the National Defense Authorization Act for Fiscal Year 2006](#), as reported by the Senate Committee on Armed Services on May 17, 2005.
<http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/64xx/doc6406/s1042.pdf>

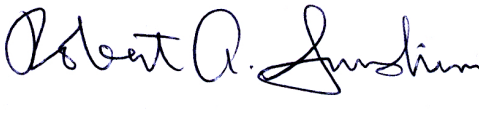
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the appropriate budgetary treatment of activities and transactions that would result from enacting the legislation in question, on the basis of the general principles that apply to federal budgeting and previous precedents; they are used by the House and Senate Budget Committees, which are ultimately responsible for determining the cost of legislation for budget enforcement purposes. Ultimately, the Office of Management and Budget and the affected executive branch agencies determine how transactions are recorded in the federal budget once legislative proposals are enacted. The details of the transactions, once they are implemented, may differ from what CBO anticipated when the legislation was being considered, or the agencies' judgments as to the appropriate budgetary treatment may differ from those of CBO.

If you want additional information on this subject, we would be happy to provide it.

Sincerely,

for 

Douglas W. Elmendorf
Director

Identical letter sent to the Honorable Mike Michaud.

cc: Honorable Bernie Sanders
Chairman, Senate Committee on Veterans' Affairs

Honorable Richard Burr
Ranking Member