APPENDIX F:

Determination of Operating or Capital Lease Classification for Budget Scoring

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1. General

a. Requirement

This policy, issued jointly by the Assistant Commissioners for the Office of Portfolio Management and Customer Engagement (PT) and the Office of Leasing (PR or OL), summarizes PT policies and procedures for determining appropriate budget scoring treatment for every real property lease transaction, as required by Office of Management and Budget (OMB) Circular No. A-11, in Appendix B. Full details on scoring and associated requirements is found on PT's Insite Leasing Policy and Guidance site.

Asset Managers undertake all lease scoring evaluations in coordination with the Leasing Specialist 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 as required by OMB Circular A-11.

b. Impact

Agencies must differentiate between operating and capital leases for purposes of budget scoring in accordance with the Budget Enforcement Act of 1990 (title XIII of the Omnibus Budget Reconciliation Act of 1990), Public Law No. 101-508 (November 5, 1990) ("BEA"). The budgetary and accounting consequences of entering into a capital lease are serious and can significantly affect PBS's rental of space budget. In the event a lease is scored as a capital lease, PBS must obligate funds from the Rental of Space budget activity account (BA-53) in the Federal Buildings Fund ("FBF") in the initial year of the lease in an amount equal to the present value of the triple net lease payments (as defined in PT's *Scoring Guidance*) plus the estimated cost of the associated annual real estate taxes over the full term of the lease. The full term is the fixed term of the proposed lease plus any options to renew that can be exercised without further congressional approval (i.e., approval for obligational authority or if at prospectus-level, prospectus approval). Appendix B of OMB Circular A-11 states that "if the lease agreement contains an option to renew that can be exercised without additional legislation, it will be presumed that the option will be exercised."

Obligations for leases are recorded in the Rental of Space budget activity account in the FBF. The Rental of Space budget activity is limited in each fiscal year to an amount appropriated by Congress, as well as any carryover balances from prior fiscal years. GSA's annual rental of space request is based on the premise that most of its leases are operating leases. Each region receives an annual allowance for rental of space limiting the total obligations it may record for existing and new leases. Unanticipated recognition of a capital lease could severely limit available funds in GSA's Rental of Space budget activity account and negatively impact PBS's ability to meet contractual obligations from that account.

For PBS to operate safely within the obligational limits of the Rental of Space account, it must be able to determine whether a lease contract constitutes an operating or capital lease. Consequently, a full and precise scoring evaluation is critical to ensuring that a lease action does not cause obligations to exceed available appropriations in the Rental of Space account. If a region exceeds its Rental of Space allowance, at a minimum, it has violated GSA's administrative fund control procedures and may cause a violation of the Antideficiency Act.

This chapter is directed solely towards scoring for budgetary purposes pursuant to Appendix B of OMB Circular A-11 and does not further address the accounting treatment of those same leases.

c. Applicability

All lease actions are evaluated for scoring in some capacity and all leases are evaluated pre-award.

2. Background

The BEA, as revised by the Balanced Budget Act of 1997, deals with assigning budget authority. The House and Senate Budget Committees, the Congressional Budget Office and OMB (acting jointly as the "scorekeepers") were directed to develop and issue specific guidelines and procedures to determine whether a lease is an operating or capital lease. OMB released OMB Circular No. A-11, Appendices A and B, in response.

Appendix A, Scorekeeping Guidelines, and Appendix B, Budgetary Treatment of Lease-Purchases and Leases of Capital Assets, of OMB 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.

3. Instructions and Procedures

Every lease action must be evaluated against the criteria detailed in Appendix B to OMB Circular No. A-11 to determine whether it is an operating or capital lease. While all lease actions must be scored, the Portfolio Management Scoring website has PT’s *Scoring Guidance*, which addresses the lease scenarios where a determination of operating lease status *without* undertaking one of the scoring criteria (the 90 percent scoring calculation) is detailed. Also see section 3(e), below, for more information on the 90 percent criterion. When a 90 percent scoring calculation is required, *Scoring Guidance* identifies the stages of a project where it is required, the time frame for the determination, and the roles and responsibilities for performing the evaluation. Additional details and resources for the scoring process and procedures is found on PT’s scoring webpage here.

a. Timely Determination

What Must Be Scored and When?

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 by Asset Managers. A determination of the lease classification as operating or capital—regardless of whether it is an interim or final determination—is made within each region.

All lease transactions are evaluated for scoring in some capacity and all leases are evaluated pre-award. The scoring model does not differentiate between leases above and below the simplified lease acquisition threshold (SLAT). Below-prospectus leases with a term over five years are evaluated at least twice – once during requirements development and again pre-award. This scoring evaluation must be made by completing the Lease Scoring Workbook.

Prospectus-level leases are evaluated a minimum of three times – during requirements development, upon submission of the prospectus to Central Office and pre-award. The requirements development and pre-award scoring evaluations must be made by completing the Lease Scoring Workbook. The scoring evaluation for submission with the prospectus package may be made by completing the single page Scoring Sheet that is made available as part of each year's Capital Investment and Leasing Program (CILP) Planning Call – Prospectus-Level Lease documentation.

While below-prospectus leases with a term over five years must be scored at least twice, and prospectus-level three times, additional scoring evaluations during negotiations is advisable if the initial determination during requirements development suggest the calculation is uncomfortably close (such as above 85% of PV/FMV) to scoring as a capital lease. This is often applicable when the term of the lease is for longer than 15 years.

Rescoring is the act of evaluating a change to a lease contract already in place. Lease transactions must be "rescored" when a change to an existing lease contract causes a change in the government's financial commitment, *even if the change causes the financial commitment to decrease.* Changes to the government's financial commitment could include changes in term, award, or effective date. While a new evaluation is required, the evaluation period begins from the point in time when the term is changed through the remaining term of the lease. Because of the 90% test, rescoring would also be required as a result of non-utilization of the full Tenant Improvement Allowance ("TIA") or Building Specific Amortized Capital ("BSAC").

b. Use of Lease Scorekeeping Classification Workbook

When the Scorekeeping Classification Workbook is mandatory (leases greater than five years), the Leasing Specialist conveys anticipated lease data to Asset Management, typically using worksheets included in the Lease Scoring Workbook to enable the Asset Manager to make the scoring determination of operating or capital lease treatment for each proposed lease action before a lease award is made. See section 7 of this Appendix entitled "The Lease Scoring Workbook" for further information on the Workbook.

c. Use of Circular A-11

The Regional Director of PT or the Regional Director's designee must follow the current OMB guidelines in Appendices A and B to Circular No. A-11 and use the current OMB discount rates provided in Appendix C to Circular No. A-94 when making the determination of lease treatment for budget scorekeeping purposes. The current version of Appendices A and B to Circular No. A-11 and Appendix C to the 2023 Circular No. A-94 can be found at:

https://www.whitehouse.gov/omb/information-for-agencies/circulars/ (Circular A-11) and

https://www.whitehouse.gov/wp-content/uploads/2023/02/M-23-12-Appendix-C-Update_Discount-Rates.pdf (Circular A-94)

(Appendix B is contained within the downloadable A-11 file).

The discount rate (Appendix C to Circular No. A-94) and Circular A-11 are revised annually, so be sure to use the most recent version when performing a scoring analysis on a lease action. Guidance on the budget scoring of leases in Appendix B is not GSA-specific and is equally applicable to delegated leases because GSA's FBF backstops these delegated leases.

d. Operating Lease Criteria

Appendix B to Circular No. A-11 ("Preparation, Submission and Execution of the Budget") 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 be 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.

e. The 90 Percent Criterion

Of the criteria that must be satisfied to be considered an operating lease, the one that presents the most frequent challenge to the PBS leasing program is the requirement that the present value of the minimum lease payments over the term of the lease does not exceed 90 percent of the fair market value ("FMV") of the asset at the inception of the lease. The Asset Manager runs the valuation on all leases longer than five years. Calculations are done using the Scoring Workbook located on the Portfolio Management Scoring website. While the Lease Scoring Workbook and the single page Scoring Sheet are both tools that can be used to calculate a lease transaction's "score," only the Lease Scoring Workbook satisfies the scoring evaluation requirements at requirements development and pre-award.

Detailed scoring guidance is contained in documents distributed by PT and available at the following weblink on PT Insite.

f. The Bargain-Price Purchase Option Criterion

Another criterion that may require additional clarification is that the lease does not contain a bargain-price purchase option. Per Appendix B to OMB Circular A-11 and page 4 of PT's June 2022 *Scoring Guidance*:

> *Bargain-price purchase option. A bargain-price purchase option is a provision allowing the Government to purchase the leased property for a price that is lower than the expected fair market value of the property at the date the option can be exercised. The purchase price includes the value of any rebates or income to the agency or Government resulting from its purchase of the asset.*

The three categories of purchase options for scoring are detailed on pages 12 and 13 in the Definitions section of PT's *Scoring Guidance* document. The specific criteria for determining what is a bargain purchase price is detailed on page 4 of that same *Scoring Guidance* document.

g. Who Completes the Scoring Evaluations?

PT is the office responsible for scoring both as a program and in execution. PT's *Scoring Guidance* is the official source for the below paraphrased information. When requesting a scoring evaluation, the Leasing Specialist provides, at a minimum, the identifying project information, anticipated rates and conditions, the breakdown of the housing plan, and any pertinent source documentation (such as market information at the requirements development phase, the draft lease, and GSA Form 1217 at the pre-award evaluation). The leasing specialist must enter this information into the scoring workbook, where possible, and supply it to PT.

PT is responsible for certifying the eight qualitative criteria are met, evaluating the workbook module appropriate to the details of the lease transaction, generating the "score," and making the final determination on whether the lease is an operating or a capital lease.

While Central Office is not dictating who fills out the "user input required" cells in the workbook to leave some flexibility to the regions, PT is ultimately responsible for the scoring evaluation, the data in the actual module that tests the 90% score, and the assessment of the qualitative criteria. The expectation is that PT Asset Managers have fully vetted the data entered.

The only exception to this is in the case of a lease term of five years or less with rental rates consistent with the market. In this scenario, the Lease Contracting Officer (LCO) can make a scoring determination on their own by completing the Common Data tab and Lease Memo Module in the Lease Scoring Workbook.

All lease acquisitions should be operating leases for budgetary purposes. This ensures the risk of ownership stays with the lessor. Exceptions to this guidance require consultation with PT *during* the development of lease proposals. Treatment as a capital lease should be done only as a considered, intentional choice with the approval of the Office of Leasing. Also, agencies with a delegation of leasing authority from GSA use GSA's leasing authority backed by the FBF. Therefore, as provided in section 4 of chapter 24 (Delegations) of the Leasing Desk Guide, agencies with a delegation of leasing authority from GSA must also follow the same scoring requirements contained in OMB Circular A-11. Any lease entered into as a capital lease for which the agency with the delegated leasing authority lacks the necessary budget authority will be counted against GSA's budget authority and will negatively impact GSA's ability to meet its obligations. The Office of Leasing's Delegated Lease Program turns scoring over to PT's Capital Allocation and Assessment Division for review.

Scoring results for project development purposes should not exceed 85 percent and scoring of leases immediately prior to lease award should have a safety margin to allow for potential modifications through lease amendments.

Leasing Specialists with scoring questions should reach out to their Asset Manager for assistance.

Agencies with a delegation of leasing authority from GSA are responsible for independently ensuring on their own that the scoring requirements are met for their delegated leases. They are not to rely on PT for scoring.

4. 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 Five Years or Less

For leases with a term of five 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 LCO can make the determination that the proposed lease is an operating lease by verifying that the lease meets the first eight criteria in subsection 1(D) of PT's *Scoring Guidance* document. The ninth criteria, the 90 percent calculation, is not required for leases with terms of five years or less.

All applicable portions of the Determination of Operating Lease Classification must be completed, signed by the LCO, 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 term over five years, the LCO must work with the Asset Manager to determine operating lease treatment as detailed in the following paragraphs.

b. Leases with a Term More Than Five Years

Early in the requirements development stage, 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
- 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 present value (PV) of the minimum lease payments—is less than 85 percent of the FMV of the construction (see section 7 below, regarding how to develop the input values for this calculation); and
- The proposed lease also meets the first eight criteria detailed in Appendix B to OMB Circular A-11.

The Leasing Specialist must request (through the Lease Due Diligence Module in G-REX) that the proposed lease be evaluated by the Asset Manager to determine operating or capital lease treatment. This is done through an initial scoring analysis (at Phase I – Requirements). When requesting a scoring evaluation, the Leasing Specialist provides, at a minimum, the identifying project information, the breakdown of the housing plan and any pertinent source documentation (*e.g.,* market information at the requirements development phase, the draft lease, and GSA Form 1217 at the pre-award evaluation). Except for final pre-award scoring, as outlined below, no additional scoring during the pre-award phase is required unless the parameters of the transaction (including term, proposed award amount, or effective date) are altered and the financial commitment changes (up *or* down). If these factors change during the lease process, the Leasing Specialist must resubmit the initial determination request with the revised terms and conditions.

A final Lease Scoring Workbook with a final scoring analysis at the pre-award phase ("Phase 3 – Apparent Successful Building" in the G-REX Lease Due Diligence Module) must be received before award to the apparent successful offeror. Data inputs required for the final Lease Scoring Workbook are outlined in section 7, below. The Leasing Specialist must request this determination by completing the data inputs in the Lease Scoring Workbook and submitting it to Portfolio through the Lease Due Diligence Module in G-REX. (All scoring analysis should be submitted to PT through the G-REX Lease Due Diligence module with the expectation that the response from PT will also be received through the module). The Lease Due Diligence Module in G-REX will also file the required documentation in the correct checklist line without additional work from the Leasing Specialist (if a signed Workbook was submitted to and approved by PT without revisions).

While these are the minimum requirements for scoring a below-prospectus lease, the Leasing Specialist may also wish to add additional scoring determinations if the initial determination is approaching scoring as a capital lease, especially if changes are made in significant scoring factors, such as length of term or the amount of rent or both.

Prior to being granted final BA-53 certification, the BA-53 analyst will verify in G-REX that the scoring analysis has been done and meets the criteria for an operating lease. Documentation in G-REX is viewed by the budget activity 53 Budget Analyst at the time of the request for certification of funds.

5. 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 the 9 criteria in Appendix B to OMB Circular A-11, including the 90 percent scoring calculation—

1. At the requirements development phase,

2. At the time of the submission of the prospectus package 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.

For further information on scoring prospectus-level leases see PT's CILP Insite webpage on GSA Insite.

b. SLAT Leases

There is no simplified scoring process for SLAT leases. Leases at or below the SLAT level are subject to the full scoring analysis as discussed under subsection 4.b, above, unless the lease term is five years or less, in which case the methodology under subparagraph 4.a, above, may be used.

c. Extensions

If the Government seeks to extend a lease for a temporary term (generally one to three years, not to exceed five 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 Appendix B to OMB Circular A-11. The 90 percent scoring calculation is not required for the determination. The Leasing Specialist must complete the Lease Scoring Workbook, Lease Less Than Five Years Memo, per PT's *Scoring Guidance* document, and include a copy in the lease project file. No further action regarding lease classification for budget scorekeeping purposes is required.

d. Expansions, Reductions, Succeeding, and Superseding

If a customer agency requests expansion or a reduction in space for a location already under lease to the Government, before committing to any expansion or reduction of 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. The Leasing Specialist or LCO must document the lease file for any action taken and follow the applicable processes described in paragraph 4, above, for the lease term.

If all 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 undertaking a scoring calculation. The Leasing Specialist or LCO must document the lease file for any action taken and follow the applicable processes described in paragraph 4, above, 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. This applies regardless of whether the option was required by the Request for Lease Proposal (Pre-Existing, Evaluated Prior to Lease Award), or freely offered (Pre-Existing/Evaluated Prior to Execution).

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 five-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 scoring evaluation. If such options are not factored into the base lease's original scoring evaluation, the scoring requirements as defined in this policy must be applied before an option can be exercised.

Additional information regarding scoring of options can be found in the Leasing Desk Guide Chapter 9, Renewal Options.

g. Parking Leases

Parking arrangements procured through a real property lease are subject to the same scoring expectations as any other lease. The scoring workbook has a module specific to parking only leases. While some of the specific calculations are different, (*e.g.,* how to calculate the FMV with existing tools), scoring a parking lease closely mirrors the scoring of any other lease.

In the case of a parking lease with a term of five years or less, the scoring evaluation is the same as with any other lease with a term of five years or less.

6. PV/FMV Above 80 percent

The Asset Manager may have concerns if the Scoring Workbook calculations yield a PV/FMV ratio above 80 percent.

7. The Lease Scoring Workbook

The primary purpose of the Lease Scoring Workbook is to evaluate and document whether a lease is subject to operating or capital lease treatment. The LCO or Leasing Specialist will complete basic project information into the Workbook and submit to the Asset Manager (through the Lease Due Diligence Module in G-REX), who will make the determination if a project results in an operating or capital lease action. Detailed instructions for the Scoring Workbook calculations are provided on the PT Insite Leasing Policy and Guidance website.

The Asset Manager will also use construction cost estimates for determining FMV, which is part of the scoring analysis. These are external inputs to the Scoring Workbook that are required to be used by the Asset Manager as part of the scoring process. These tools are operated and maintained by the cost estimating group in the Office of Design & Construction.

The following information is provided by the LCO or Leasing Specialist to the Asset Manager using the Scoring Workbook:

- Project identifying information, including name, location, client agency, REXUS project number, prospectus number (if applicable), and responsible Office of Leasing contact information.
- Length of the lease (*i.e.,* the term, including options, except when additional prospectus approval is required to exercise the option(s)).
- Length of the amortization term.
- The ANSI BOMA square feet to be leased broken down by space type.
- Rentable/Usable Factor.
- Number of parking spaces broken out into structured and surface spaces.
- Anticipated date of lease award.
- Estimated lease effective date.
- Amount of broker commission credit (if applicable) and the number of months the credit is applied.
- Amount of free rent (if applicable) and the number of months the credit is applied.
- Parking rates (surface and structured, if applicable).
- Parking rate escalation (if applicable).
- Rent rate components expressed on a per rentable square foot basis – shell rent, tenant improvement costs, building specific amortized capital costs, and operating expenses.
- Supporting financial costs (if available) expressed on a per rentable square foot basis – taxes, insurance, lessor management costs, and repair reserves.
- For prospectus projects, there is a tab in the Scoring Workbook that does a prospectus check on the offer to make sure that the levelized rent does not exceed the prospectus threshold. This tab is primarily automatically completed and is provided as a guide or tool.

It does not have to be completed for the scoring workbook to be considered full and complete.

The LCO or the Leasing Specialist signing the Scoring Workbook prior to submission to Asset Management (using the Lease Due Diligence Module in G-REX) will result in the filing of the documentation in the correct checklist lines without additional work from the Leasing Specialist (if a signed Workbook was submitted to and approved by PT without revision).

To learn more about Lease Scoring, including completing the Scoring Workbook for special circumstances, check the Portfolio Management Scoring website.

The Lease Scoring Workbook is owned and maintained by PT and is available at the Planning Policy and Guidance page on the PT Leasing Policy and Guidance Insite page.