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LONG-TERM LEASING OF BUILDINGS AND LAND BY GOVERNMENT CONTRACTORS

The General Accounting Office review of the long-term leasing of buildings and land by one contractor, the Lockheed Missile & Space Company disclosed that this method of acquiring facilities is more costly to the Government than would be the case if the contractor had constructed and retained ownership of the property for use on Government work. We believe that current provisions of the Armed Services Procurement Regulation provide an incentive for contractors to rent and should be reconsidered by the Department of Defense.

Lockheed entered into noncancelable leases on property which cost about \$27 million, for a 25-year period, which committed it to pay total rentals of about \$46 million. Although the cost of the land and interest expense on the contractor's investment in buildings and land would not have been reimbursable under the Government cost-reimbursement contracts in effect, the contractor, through the long-term leasing arrangements, is being reimbursed for all costs of the property. If the use of the facilities continues almost exclusively for negotiated Government work over the initial 25-year period of the leases, the Government will pay, through reimbursement of rental payments, about \$19 million more than the cost of the buildings, which would be the amount chargeable to Government contracts as depreciation if the contractor owned the property.

Under these conditions, however, the contractor will save during this same period a substantial amount, which we estimate at about \$10 million, in interest expense which it would have incurred to finance ownership of the facilities. Also, the higher leasing costs are included in the cost base in establishing fees or profits on Government contracts. Furthermore, under the current Armed Services Procurement Regulation guidelines for establishing the source of resources portion of the contract profit allowances, a contractor is allowed the same profit or fee consideration for furnishing the facilities whether they are owned, and the contractor absorbs the financing costs, or whether they are rented, and the contractor passes the rental costs, which would include the owner's financing costs, on to the Government.

In commenting on a draft of this report, both Lockheed and the Department of Defense emphasized the risk that Lockheed took by entering into the 25-year noncancellable leases without the assurance that its work under Government contracts would continue during the entire period.

However, the Department agreed with our position that the risk is substantially the same whether the contractor purchases the facilities or acquires them through long-term leasing arrangements. The Department stated that it was aware of the magnitude of the leasing costs and that it was not precluded by the Armed Services Procurement Regulation from considering the reasonableness of the costs of leasing in any current or future negotiations. Further, the Department stated that the Armed Services Procurement Regulation Committee would be requested to review the rental cost principle, particularly under noncancellable, long-term leases. The Department also advised that consideration of revisions to the weighted guidelines, which