

## Recommendation 56: Use authority in Section 1077 of the FY 2018 NDAA to establish a revolving fund for information technology modernization projects and explore the feasibility of using revolving funds for other money-saving investments.

### Problem

The federal government's apparent inability to internally finance projects that show promise for improving agency efficiency and effectiveness—such as recapitalizing facilities, upgrading IT systems, and improving the energy efficiency of existing systems—frustrates federal agencies and contractors alike. In some cases, private contractors offer to finance such projects on behalf of federal agencies, only to be told such action is impossible under the budgetary *scoring* rules.

### Background

The most important factors in determining whether or not a lease, lease–purchase, or other capital-intensive federal facility or equipment recapitalization or upgrade project is funded should be the validity of the requirement, whether the project is executed properly and delivers quality goods and/or services, and whether the price is fair. Notwithstanding, a project's budget score also can play a role in the government's decision to move forward with a project.

The manner in which a project is scored is governed by complex scorekeeping rules (also known as the scorekeeping guidelines) promulgated by OMB and Congressional Budget Office (CBO). The budget scorekeeping roles of OMB and CBO are an outgrowth of the modern era of concern about federal spending and deficits. The scorekeepers play a role analogous to an independent test and evaluation entity for weapons performance—enforcing a neutral set of rules to ensure a level playing field on which potential investments compete for funding.

The ability of a government agency to engage in a long-term capital or real property project is governed by the OMB A-11 scorekeeping rules (adopted in 1991).<sup>1</sup> 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.

Perhaps because these rules have at times been perceived as too rigid, exceptions to the rules have occasionally been made. In addition, multiple mechanisms have been developed that ensure certain types of projects receive favorable scoring treatment or are otherwise exempt from the requirement to have full budgetary authority up front. For example, the exception for operating leases provides that the lease payments due in each year are scored only in that year, and not upfront. Energy savings performance contracts (ESPCs) and enhanced use leases promise increased resources through energy savings and other efficiencies that pay for themselves over time. DoD relies on these existing authorities for efficient use of its real estate assets, so the first principle in this area should be to *do no harm* to this foundation when seeking even greater flexibility.

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<sup>1</sup> OMB Circular No. A-11, *Appendix B—Budgetary Treatment of Lease-Purchases and Leases of Capital Assets*, accessed November 3, 2018, [https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/a11\\_current\\_year/app\\_b.pdf](https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/a11_current_year/app_b.pdf).

Additional flexibility could assist in ensuring that DoD's infrastructure needs are met and that additional exceptions could or should be drawn. CBO and OMB have historically been opposed to such mechanisms, although over time OMB has granted exceptions ad hoc. Some have suggested that CBO and OMB opposition has been driven in part by a reaction to the 2001 Air Force tanker lease proposal, which appears to have been attractive to the Air Force because the lease costs would not have to be paid until after the end of the Future Years Defense Program.

As such, any proposal to change the current scorekeeping rules should be tailored to meet the objectives behind the scorekeeping rules: ensuring that the budget-making process is as fair and transparent as possible.

## Discussion

### ***Revolving Funds for Money-Saving Investments***

Federal law and regulations permit the use of private-sector capital to augment federal funds under certain circumstances. Among these mechanisms are Energy Savings Performance Contracts (ESPCs) and Utility Energy Service Contracts (UESCs). These arrangements permit DoD to third-party financing as private contractors invest in energy-saving improvements on behalf of the federal government and are paid out of the resulting savings. Under OMB memoranda M-98-13 and M-12-21, OMB does not treat these facilities investments as capital improvements (which would require scoring the net present value of the government's obligations of the contract up front), but rather, scores payments to contractors on an annual basis as they are made.

In principle, the ESPC/UESC *safe harbor* approach could be applied to other money-saving investments, such as aircraft re-engining programs that promise a similar stream of savings in reduced fuel and maintenance costs. By mandating a minimum level of return on investment or payback period, and requiring that contractors be paid out of the savings, the government could ensure these programs would pay for themselves over time, rather than simply push off investment costs onto future taxpayers.

CBO and OMB have historically been opposed to additional mechanisms that would allow annual scoring of private financing mechanisms. The use of public, rather than private-sector, financing could be one way of avoiding this political problem. One potentially viable method of alternative public financing could be increased use of revolving funds.

In particular, the federal government could establish revolving funds with the express purpose of investing in money-saving improvements. Reimbursement of the revolving funds would be tied to money saved as a result of increased efficiencies. After an initial investment, the revolving funds should, in theory, pay for themselves. Because the financing mechanism would be internal to the government, this approach should not be subject to the OMB and CBO scoring problems hindering private-sector financing proposals.

Tying the reimbursement of the funds to any savings achieved would create several complexities. Agencies would be required to estimate future savings, which can be difficult and is subject to a number of assumptions. Actual savings would be difficult to determine because of external factors, such as increased operational tempo and changes in maintenance standards or schedules. Savings

would appear in multiple accounts of different DoD organizations, requiring some kind of mechanism to ensure that entities realizing the savings would reimburse the entity paying the contractor bills.

The Information Technology Systems Modernization Funds authorized by Section 1077 of the FY 2018 NDAA is an attempt to address these issues, authorizing federal agencies to establish revolving funds for IT modernization projects. DoD elected not to take advantage of Section 1077 authority. In a memorandum to Congress, the DoD Chief Information Officer (CIO) stated, “The Department appreciates the subcommittee’s advocacy of Defense IT systems, and the authority Modernizing Government Technology (MGT) Act provides. However, we believe our existing Working Capital Fund (WCF) structure, policies, and processes provide the type of flexibilities and incentives envisioned by the MGT Act.”<sup>2</sup> DoD should still exercise this opportunity and put in place a pilot program for IT investments as authorized in the FY 2018 NDAA. The pilot’s success would help determine whether a similar process could be applied toward other investments for which savings would be used to reimburse the fund and allow contractors to be paid on an annual basis. Re-engining aircraft is one area where such a model might be applied.

### ***Revolving Funds Not Expressly Tied To Savings***

The complexities associated with estimating future savings, and then accounting for those savings when they occur, could potentially be avoided by developing a method of public financing whereby repayments are tied to annual appropriations. This is the method endorsed by OMB and the current administration in the *Analytical Perspectives* volume of the FY 2019 budget, which proposes a Federal Capital Revolving Fund (FCRF) for investments in nondefense capital infrastructure. As OMB explained, “balances in the FCRF would be available for transfer to purchasing agencies to fund large-dollar capital acquisitions to the extent projects are designated in advance of appropriations Acts and the agency receives a discretionary appropriation for the first of a maximum of 15 required annual repayments.”<sup>3</sup> Agencies would borrow from the FCRF to cover the full cost of acquiring a capital asset and then repay the FCRF over time using appropriated funds. Because “future discretionary appropriations will have to be used to repay the FCRF” rather than all from the agencies’ discretionary budgets in the first year, OMB believes that this structure will “provide an incentive for agencies, OMB, and the Congress to select projects with the highest mission criticality and return.”<sup>4</sup>

If this approach is successfully implemented for federal civilian agencies, it may be useful for DoD as well. DoD should explore use of revolving funds for which reimbursement is tied to appropriations rather than savings.

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<sup>2</sup> Chief Information Officer Memorandum to U.S House of Representatives, Committee on Oversight and Government Reform, Subcommittee on Information Technology, dated May 21, 2018.

<sup>3</sup> OMB, *An American Budget: Analytical Perspectives, Fiscal Year 2019*, February 2018, 119, accessed November 4, 2018, <https://www.whitehouse.gov/wp-content/uploads/2018/02/spec-fy2019.pdf>. The principle in the fund would be provided by Congress through direct spending which would be subject to the PayGo requirements that any increase in direct spending be offset by reductions in other direct spending or an increase in revenue. This paper assumes that Congress will find such a fund a high enough priority that it will provide the requisite direct spending. The subject of this paper is the scoring by OMB of long-term projects whether reliant upon a federal capital revolving fund or otherwise.

<sup>4</sup> OMB, *An American Budget: Analytical Perspectives, Fiscal Year 2019*, February 2018, 120, accessed November 4, 2018, <https://www.whitehouse.gov/wp-content/uploads/2018/02/spec-fy2019.pdf>.

### ***Current and Past Program-Specific Interpretations to the Scoring Rules***

DoD currently uses several mechanisms that allow supplementing federal funds with private-sector capital under specific circumstances, in addition to ESPCs and UESCs. Among those mechanisms are enhanced-use leasing, public-private partnerships (P3s), capital leases, and performance-based service contracts (e.g., for aircraft engine maintenance).

At times, OMB has interpreted the scoring rules as mandating differing treatment for these types of public-private endeavors. The deal structure determines whether a project must be scored upfront. For example, in 1997, OMB Director Franklin D. Raines issued guidelines (the Raines Memo) that provided extensive guidance on how different types of Military Family Housing Privatization Initiative (MHPI) transactions would be scored. Among other things, the Raines Memo gave DoD authority to convey property in exchange for housing or an equity investment in a limited liability company. Under these circumstances, there would be no scoring impact if there was no cash income or expenditure. According to an Army history of the MHPI program, it was this clear scoring guidance that enabled the privatization program to proceed.<sup>5</sup>

OMB has at times interpreted its scoring rules to exempt certain types of long-term projects, including those involving private capital, from being fully scored upfront. Commissioning a study of these past interpretations would allow better insight into why OMB scores certain types of projects differently than others. Understanding the factors that led to these scoring outcomes would provide additional predictability to both DoD and the private sector when considering pursuing such projects. The lessons learned could be used to identify candidates for future projects.

### ***A Study of Mature Statutory and Regulatory Regimes from Other Jurisdictions***

A form of financing public infrastructure that has gained traction in recent years in state and local jurisdictions, as well as internationally, is the P3. Jurisdictions that have recognized the benefits of P3s have adopted legislation and regulation to authorize and then guide their P3 programs. The federal government is outpaced by states such as Virginia and countries such as Canada when it comes to P3 program use. Many developing countries are in the process of putting in place such legislation.

Currently, no comprehensive statutory regime exists that governs circumstances under which DoD may make use of a P3. P3s are not appropriate for all situations, but when they are, they could be an additional tool to address DoD's infrastructure requirements. A study of mature P3-authorizing statutes and regulations from other jurisdictions could assist in determining whether the P3 model could be further implemented at the federal level and include analysis of how P3 projects would be scored by OMB.

### **Conclusions**

DoD is unlikely to obtain approval for private financing of public investment projects under current conditions because such financing could be seen as a maneuver to get around the budget rules and require future generations to pay for today's investments. Internal investments in money-saving efficiencies (such as upgraded IT systems or more fuel-efficient engines) may pay for themselves out of

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<sup>5</sup> Matthew C. Godfrey et al., *Privatizing Military Family Housing: A History of the U.S. Army's Residential Communities Initiative, 1995–2010* (Washington, DC: GPO, 2012), 41, accessed November 4, 2018, [http://www.rci.army.mil/programinformation/docs/RCI\\_history.pdf](http://www.rci.army.mil/programinformation/docs/RCI_history.pdf).

future operation and maintenance funds savings. In these cases, there is a public financing alternative that may be acceptable: the use of a revolving fund that provides financing for an initial set of investments. If the savings from the initial investments can be tracked and used to reimburse the revolving funds, additional money-saving investments could follow.

DoD could conduct studies to assess whether other approaches to financing public projects could be viable. For example, the recently proposed FCRF is intended to be a revolving fund that is reimbursed out of annual appropriations, instead of from savings. Although the FCRF is intended to fund investments in civilian infrastructure, DoD could study whether such a model would work for defense infrastructure and could explore the characteristics that led OMB to interpret its budget scoring rules in favorable ways (i.e., from lower upfront scores to the continuation of individual projects or programs, including projects and programs that employ private sector financing). Better predictability of how projects and programs will be scored will encourage initiation of such projects or programs, or a decision not to begin at all. Models of mixed public-private financing, such as the P3s, could be studied to determine whether such a model would be as feasible at the federal level as they are at state and local levels as well as internationally.

The Secretary of Defense should issue a memorandum requiring DoD to use the authority in Section 1077 of the FY 2018 NDAA to establish a revolving fund for IT modernization projects. This revolving fund should serve as a pilot program to prove the feasibility of using the revolving fund mechanism to finance continuous, money-saving upgrades to DoD systems and facilities. To ensure the success of the pilot program, DoD should establish specific guidance for estimating future savings from IT investments financed through the revolving fund, tracking actual savings and identifying the accounts in which they accrue, and ensuring the transfer of savings to the extent needed to reimburse the revolving fund for initial investments.

If DoD is able to navigate these hurdles and successfully implement the IT revolving fund on an ongoing basis, it should seek additional authority to use revolving funds for other money-saving investments, such as aircraft re-engining programs.

- DoD should commission a feasibility study for using the revolving fund for capital projects, to be reimbursed annually out of appropriations, similar to the FCRF.
- DoD should analyze the characteristics of projects and programs that OMB has employed when accepting that such projects and programs do not require full, upfront scoring, whether the projects are privately or publicly financed. The goal of the study would be to make transparent the additional, and currently unstated, factors that OMB will consider.
- DoD should commission a study of mature P3 authorizing statutes and regulations from which to develop and adopt federal level P3 statutes and regulations for DoD to promote infrastructure projects in partnership with the private sector.



## Implementation

### ***Legislative Branch***

- Authorize \$100 million to be appropriated to the Secretary of Defense for a revolving fund established under Section 1077 of the FY 2018 NDAA (Pub. L. No. 115–91; 40 U.S.C. § 1130 note) to fund an IT systems modernization pilot.
- Appropriate \$100 million for a revolving fund established under Section 1077 of the FY 2018 NDAA (Pub. L. No. 115–91; 40 U.S.C. § 1130 note) to fund an IT systems modernization pilot.
- Authorize the transfer of savings back to the revolving fund, to the extent needed to reimburse the revolving fund for initial investments in money-saving IT projects. These transfers would be subject to the appropriations process under the same terms and conditions laid out in section 1077.

### ***Executive Branch***

- Issue a decision memorandum directing establishment of a pilot Information Technology Systems Modernization Fund pursuant to section 1077 of the FY 2018 NDAA.
- Direct the Under Secretary of Defense(Comptroller) (USD(C)), in consultation with the CIO, to provide guidance for estimating future savings from IT investments financed through the revolving fund; tracking actual savings and identifying the accounts in which they accrue; and ensure the transfer of savings to the extent needed to reimburse the revolving fund for initial investments.
- Request legislative authority—on completion of one successful round of investments, up to and including reimbursement of the revolving fund for initial investments—to establish additional revolving funds for other money-saving investments, such as aircraft re-engining programs.
- Commission studies of the following:
  - The advantages and disadvantages of a revolving fund for capital projects, to be reimbursed annually out of appropriations, similar to the FCRF.
  - The factors OMB uses when agreeing to exceptions to the current budget scoring rules, including for specific projects and programs.
  - Mature P3 authorizing statutes and regulations from which to develop and adopt federal P3 statutes and regulations for DoD to promote infrastructure projects in partnership with the private sector and to study the scoring of such projects by OMB.
  - Other executive branch changes to analyze mechanisms to improve industrial capitalization.Recommended studies are included in the Section 809 Panel’s *Volume 3*, Section 2.

### ***Implications for Other Agencies***

- There are no cross-agency implications for this recommendation.

## RECOMMENDED REPORT LANGUAGE

### SEC. \_\_\_. REVOLVING FUND TO FINANCE MONEY-SAVING INVESTMENTS.

This section would direct the Secretary of Defense to use the authority in Section 1077 of the National Defense Authorization Act for Fiscal Year 2018 (P.L. 115-91) to establish a revolving fund for an information technology (IT) modernization pilot and explore the feasibility of using revolving funds for other money-saving investments.

The committee recognizes the need to create financing opportunities to internally finance projects that show promise for improving agency efficiency and effectiveness—such as recapitalizing facilities, upgrading IT systems, and improving the energy efficiency of existing systems. The funding authority in Section 1077 of the FY 2018 NDAA offers an opportunity to establish a revolving fund for information technology modernization projects. This revolving fund would serve as a pilot program to prove the feasibility of using the revolving fund mechanism to finance continuous, money-saving upgrades to Department of Defense systems and facilities.

The committee notes that the most important factors in determining whether or not a lease, lease–purchase, or other capital-intensive federal facility or equipment recapitalization or upgrade project is funded should be the validity of the requirement, whether the project is executed properly and delivers quality goods and/or services, and whether the price is fair. A project’s budget score also may play a role in the government’s decision to move forward with a project. The committee further notes that the new fund created under this section could be used as a pilot program to gauge the feasibility of easing the financing rules for certain projects. In addition, the committee expects the Secretary of Defense to conduct studies on public–private funding in other countries and at state and local levels, and the exceptions that have been granted to the Office of Management and Budget scoring rules to determine what would need to be done to increase opportunities for equipment recapitalization. This section would require a report on implementation of the revolving fund be delivered to congressional defense committees within 180 days of enactment as well as a subsequent report on the Secretary’s further analysis within one year.

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1 **SEC. \_\_\_\_ . REVOLVING FUND TO FINANCE MONEY-SAVING INVESTMENTS.**

2 (a) ESTABLISHMENT OF FUND.—The Secretary of Defense shall—

3 (1) use the authority in section 1077 of the National Defense Authorization Act  
4 for Fiscal Year 2018 (Public Law 115-91; 40 U.S.C. 11301 note) to establish a revolving  
5 fund to finance information technology modernization projects and to be reimbursed  
6 through savings on such projects; and

7 (2) if the revolving fund established pursuant to paragraph (1) is successful, seek  
8 authority from Congress to establish additional revolving funds for other money-saving  
9 investments, including investments in the fuel efficiency of weapon systems.

10 (b) IMPLEMENTATION REPORT. —

11 (1) Not later than 180 days after the date of the enactment of this Act, the  
12 Secretary of Defense shall submit to the congressional defense committees a report on the  
13 implementation of the revolving fund established pursuant to subsection (a).

14 (2) The report shall include—

15 (A) a time-phased plan for the implementation of the revolving fund; and

16 (B) an explanation of any congressional action (including any new or  
17 additional transfer authority) that may be needed to ensure that future savings  
18 from information technology modernization projects are available to reimburse  
19 the revolving fund for investments in such projects.

20 (c) ADDITIONAL STUDY AND REPORT. — Not later than one year after the date of the  
21 enactment of this Act, the Secretary of Defense shall submit to the congressional defense  
22 committees a report on—

1           (1) the feasibility and advisability of establishing one or more revolving funds that  
2           are not reimbursed through savings to finance defense infrastructure recapitalization  
3           projects;

4           (2) the existing statutory and regulatory regimes that govern the use of public-  
5           private partnerships to finance defense infrastructure recapitalization projects; and

6           (3) any favorable interpretations of the existing scoring rules by the Office of  
7           Management and Budget or the Congressional Budget Office that may apply to private  
8           sector financing of defense infrastructure recapitalization projects.

9           (d) AUTHORIZATION.—There is authorized to be appropriated to the Secretary of Defense  
10          the amount of \$100,000,000 to be available only for deposit into the revolving fund established  
11          pursuant to subsection (a).