

THE ANNUAL DEFENSE BUDGET PROCESS

Presented by
Corporate Office
Properties Trust



Mandatory versus Discretionary Federal Spending

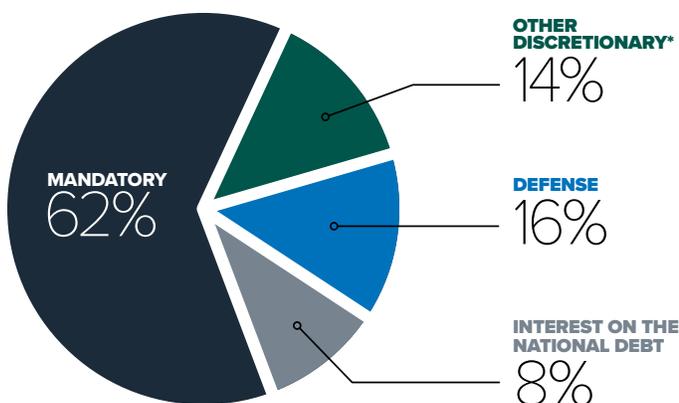
The federal budget consists primarily of mandatory spending and secondarily of discretionary spending. According to the Congressional Budget Office, mandatory (or “direct”) spending includes funding for entitlement programs such as Social Security, Medicare/Medicaid, unemployment compensation, and interest expense payments on the National Debt. Some mandatory spending programs, like Social Security, are perpetual programs, whereas others (for example, certain agriculture programs) expire at the end of a given period. Mandatory funds are automatically obligated (spent) because of previously enacted laws.

House and Senate Appropriations Committees control discretionary spending through budget authorizations and annual appropriations legislation. The federal budget year (“fiscal year,” “FY,” or “budget year”) begins on October 1st of each calendar year. Congress must pass 12 discretionary spending appropriations bills for each fiscal year to fund the following departments and their related agencies; however, Congress often rolls these 12 into a single “omnibus” bill:

1. Agriculture, Rural Development, Food & Drug Administration
2. Commerce, Justice, Science
3. Defense¹
4. Energy & Water Development
5. Financial Services & General Government
6. Homeland Security
7. Interior, Environment
8. Labor, Health & Human Services, Education
9. Legislative Branch
10. Military Construction¹, Veterans Affairs
11. State, Foreign Operations
12. Transportation, Housing & Urban Development

As the pie chart below shows, in FY 2019, approximately two-thirds of the federal budget will fund mandatory spending programs, plus another 8% interest payments on the National Debt, representing 70% of total federal spending. The remaining 30% of the federal budget funds discretionary programs. Approximately half of the FY 2019 discretionary spending will fund the Department of Defense’s (“DoD”) budget, which represents about 16% of total federal spending.

FISCAL YEAR 2019 PROPOSED FEDERAL SPENDING



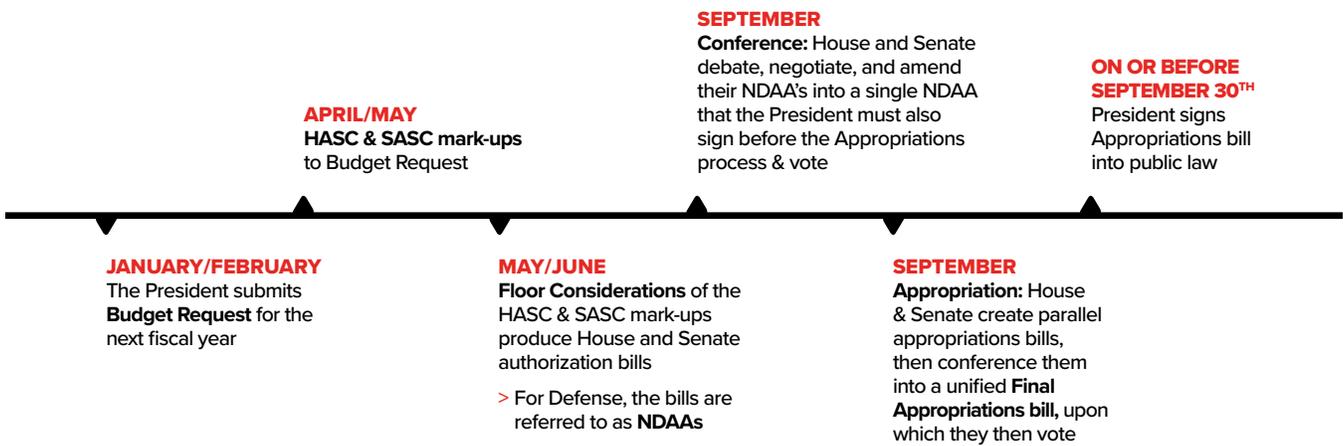
* Other Discretionary excludes the FY 2019 NDAA, which is shown separately.
Source: <https://www.thebalance.com/u-s-federal-budget-breakdown-3305789>

¹ The Pentagon typically shows military construction as part of the DoD’s total budget request, even though Congress appropriates for it in a separate bill.



Defense Budget Process

In theory, each fiscal year's budget process consists of six steps:



- 1. Budget Request.** The President establishes strategy and formulates each fiscal year's budget request with the DoD. In late January or early February, the President submits the Budget Request to the authorizing Congressional subcommittees (or Committees of Jurisdiction) through the Office of Management and Budget.
- 2. Committees of Jurisdiction mark-ups.** For Defense, the Committees of Jurisdiction are the House Armed Services Committee ("**HASC**"), the Senate Armed Services Committee ("**SASC**"), and their respective subcommittees. The subcommittees prepare authorizing legislation that will become that budget year's National Defense Authorization Act ("**NDAA**").

NDAА AUTHORIZING COMMITTEES OF THE 114TH CONGRESS

HASC Subcommittees:	SASC Subcommittees:
> Tactical Air & Land Forces	> Airland
> Military Personnel	> Personnel
> Seapower & Projection Forces	> Seapower
> Strategic Forces	> Strategic Forces
> Readiness	> Readiness & Management Support
> Emerging Threat & Capabilities	> Emerging Threats & Capabilities
> Oversight & Investigations	

Source: Congressional Research Service, "In Focus" Defense Primer: The NDAA Process (November 28, 2016)



3. Floor Consideration of Authorization Measures. Once authorization legislation is out of each committee, it goes to the floor of the House and the Senate for debate and amendment. The House and Senate both produce their own defense authorization bills, which they ultimately must negotiate into a unified authorization act before sending it to the President.

Authorization Measures establish or modify the federal government's agencies' activities or programs. Authorization provisions may be permanent, multi-year, or annual in duration. Budget authority is the legal right for an agency to enter into contracts and obligations that will be funded by future expenditures or outlays. **Agencies must obligate their budget authority in each fiscal year the funds are appropriated, but outlays may occur over time.**

According to the *Congressional Research Service* ("CRS"), the NDAA for any given fiscal year provides budget authority for the DoD, nuclear weapons programs of the Department of Energy, and the DoD elements of the Intelligence Community. Each year's NDAA also establishes the DoD's defense policies, restrictions, and organizational administrative matters.

Authorization sets policy.
Appropriation funds authorized policy.

4. Conference. The House and Senate chambers negotiate their respective defense authorizations into a unified NDAA, which the President then reviews for signature. The President can veto the NDAA, sending it back for further modification, or sign it.

FUN FACT: Congress passed the first NDAA in 1961; prior to then, the DoD had to seek prior approval only for military construction projects.

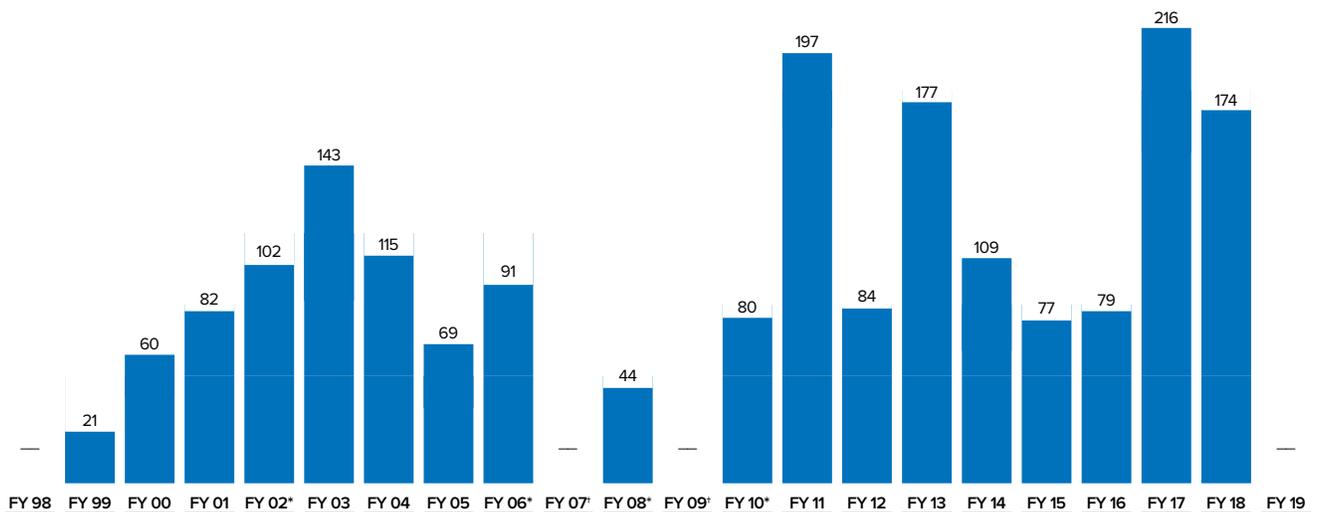
5. **Appropriations** legislation funds discretionary authorized activities. Similar to the budget authorization process (described in steps 3 and 4), the House and Senate work in parallel on their own appropriations bills of the NDAA. The two chambers must then negotiate a single appropriations bill that will be sent to the President.

In any given fiscal year, there can be three types of appropriations (funding) measures:

- i. **Regular appropriations bills**, whereby the 12 House and 12 Senate Appropriations Committees debate, amend, and pass the 12 departmental appropriations bills each fiscal year. When Congress combines several of the 12 appropriations bills into one piece of legislation (often to expedite negotiations), they create an **Omnibus** appropriations measure.
- ii. **Continuing resolutions (“CRs”)**. If some or all of the 12 appropriations bills are not enacted by midnight on September 30th, Congress usually passes a continuing resolution to grant temporary budget authority for a specified period of time. According to *CRS*, since FY 1977, Congress has begun a fiscal year with all 12 regular appropriations bills enacted only four times: FY 1977, FY 1989, FY 1995 and FY 1997. In all other years, Congress needed to enact at least one CR to complete the regular appropriations bills. As the chart below shows, commencing a fiscal year under a CR increasingly has become the norm, rather than the exception.
- iii. **Supplemental appropriations**. When resources provided through the normal, annual appropriations process may be inadequate or not timely, the President may request and Congress may enact supplemental appropriations measures. Examples of supplemental appropriations include response and recovery costs related to natural disasters, such as hurricanes.

6. **Presidential Signature**. Typically within hours of Congress passing appropriations legislation, the President signs the Appropriations bill into law. However, the President has 10 days to consider the legislation before signing or vetoing it.

NUMBER OF DAYS DoD HAS OPERATED UNDER A CONTINUING RESOLUTION



Source: Congressional Research Service, FY 2017 Defense Spending Under an Interim Continuing Resolution (CR); In Brief; Capital Alpha; COPT IR Department
 * Represents CR length affecting Defense; other budget functions were passed into law on different dates.
 † Represents years during which Defense budget was passed before the fiscal year began; other budget components were subject to CRs of varying length.

NOT-SO-FUN FACT: In recent history, the U.S. Government has begun its fiscal year with a budget in place only four times; in fiscal years 1977, 1989, 1995 and 1997. Until FY 2019, the DoD had not begun a fiscal year with a budget in place since FY 2009.



Components of the Defense Budget

The federal budget consists of functions referenced by number for consistency. The National Defense (*function 050*) budget consists of the following subfunctions:

- > **051:** the Department of Defense, including overseas contingency operations (“OCO,” or war efforts)
- > **053:** Atomic Energy Defense Activities (“nukes”)
- > **054:** Defense Related Activities, including the Departments of Justice and Homeland Security, and the Central Intelligence Agency

Typically, the 051, 053 and 054 subfunctions respectively account for 96%, 3%, and 1% of National Defense (050) funding.

AVERAGE HISTORICAL PERCENTAGE OF SELECT ACCOUNTS WITHIN THE DoD (SUBFUNCTION 051)

> Fiscal Years 2001–2007

41%	Operations & Maintenance (O&M)	Cost of ground, sea, and air operations, equipment repair, and maintenance of defense facilities, healthcare costs, and administration
24%	Military Personnel (MILPERS)	Pay and allowances, and various benefits including military retirement funds
19%	Procurement	Acquisitions of weapons and support systems
12%	Research, Development, Test & Evaluation (RDT&E)	Basic research and development of new weapons and equipment
2%	Military Construction (MILCON)	Facility management and construction

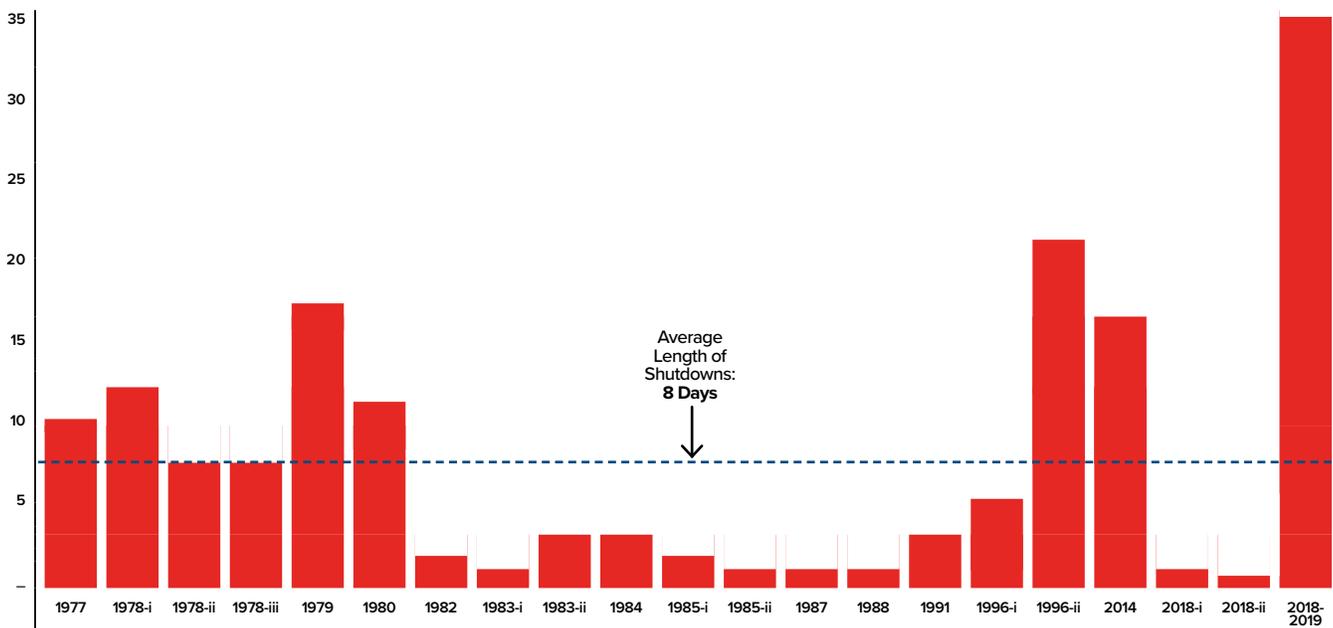
Source: Congressional Research Service report dated March 17, 2017; www.crs.gov

Brief Overview of U.S. Government Shutdowns

A U.S. Government shutdown (also known as a federal funding gap) occurs when Congress fails to pass an Appropriations bill, or if the President vetoes it. Congress can override a Presidential veto and avoid a shutdown by passing the Appropriations bill by a two-thirds vote in both the House and the Senate. Since FY 1977, there have been 21 U.S. Government shutdowns, summarized in the chart below, and lasting eight days on average.

During a shutdown, The Antideficiency Act (“ADA”) prevents the U.S. Government from spending or obligating funds that have not been appropriated. As a result, the U.S. Government furloughs “non-excepted personnel”—meaning those employees who are not involved in government activities that ensure “the safety of human life or the protection of property” are put on non-paid leave until funds are appropriated. Military personnel on active duty, public safety personnel (e.g., firefighters and law enforcement), C4ISR (“command, control, communications, computer, intelligence surveillance, and reconnaissance”) activities, and other personnel and activities involved in matters of National Security are excepted from shutdowns. Simply put, **the DoD and intelligence communities do not shutdown during federal funding gaps**. Furthermore, the Prompt Payment Act (“PPA”) requires the federal government to pay valid invoices submitted by vendors—such as rent—promptly, even during a shutdown.

NUMBER OF DAYS THE U.S. GOVERNMENT HAS SHUTDOWN, FY 1977–PRESENT



Source: Congressional Research Service, Federal Funding Gaps: A Brief Overview by Jessica Tollestrup (October 11, 2013); other U.S. Government documents; Capital Alpha; COPT’s IR Department





CORPORATE OFFICE PROPERTIES TRUST

6711 Columbia Gateway Drive, Suite 300

Columbia, MD 21046

ir@copt.com // www.copt.com // NYSE: OFC

