EMPLOYMENT AND TRAINING ADMINISTRATION ADVISORY SYSTEM U.S. DEPARTMENT OF LABOR Washington, D.C. 20210	CLASSIFICATION SWA Real Property CORRESPONDENCE SYMBOL OFAM DATE October 20, 2004

TRAINING AND EMPLOYMENT GUIDANCE LETTER NO. 7-04

TO: ALL STATE WORKFORCE LIAISONS
ALL STATE WORKFORCE AGENCIES

FROM: EMILY STOVER DeROCCO
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SUBJECT: Issues Related to Real Property Used for ETA Program Purposes

1. **Purpose**. To provide guidance relating to the use of State Workforce Agency (SWA) buildings for One-Stop purposes, the effect of such use on pre-existing amortization arrangements, and other matters concerning use of real property by SWAs and the Workforce Investment Act (WIA) One-Stop system.

2. **Scope**. Except as otherwise indicated, this TEGL is applicable to all real property occupied by ETA grantees using Reed Act funds or grant funds provided under the Wagner-Peyser, Unemployment Insurance, and Workforce Investment Act programs.

3. **Table of Contents and Topical Outline**

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4. Authorities and References. OMB Circular A-87 (Revised May 10, 2004), Cost Principles for State, Local, and Indian Tribal Governments; OMB Circular A-122 (Revised May 10, 2004), Cost Principles for Non-Profit Organizations; OMB Circular A-21 (Revised May 10, 2004), Cost Principles for Educational Institutions; Workforce Investment Act (WIA) Section 193 - Use of Certain Real Property, 29 U.S.C. 2943 (1998); 20 CFR 667.260 – May WIA title I funds be spent for construction? (2000); Wagner-Peyser Act (as amended) (W-P Act), 29 U.S.C. Sec. 49a-l (1998); Social Security Act (SSA), Title III, Grants to States for Unemployment Compensation Administration, 42 U.S.C. Sections 501-504 (1935); SSA Sec. 903(c) (Amounts Transferred to State Accounts – Reed Act, as amended), 42 U.S.C. 1103(c)(1990); 29 CFR part 97, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments (1988); General Administration Letter (GAL) 5-94, Acquisition, Use, and Disposition of SESA Real Property, Jan. 24, 1994 (expired); UI State Quality Service Plan, ETA Handbook 336, 1986-2004; Resource Sharing for Workforce Investment Act One-Stop Centers: Methodologies for Paying or Funding Each Partner Program's Fair Share of Allocable One-Stop Costs, 66 Fed. Reg. 29638 (May 31, 2001); Statement of Financial Accounting Standards No. 13, Accounting for Leases, Financial Accounting Standards Board; Attorney General Opinions, 39 U.S. Op. Atty. Gen. 229 (1939) and 39 U.S. Op. Atty. Gen. 296 (1939); One-Stop Financial Management Technical Assistance Guide, July 2002.

5. **Background.** The Department of Labor (DOL), Office of Inspector General (OIG) has done several reviews of the management of real property acquired with grant funds provided to the states under the Wagner-Peyser Act, as amended (W-P) and Title III of the Social Security Act. The funds were provided for administering the employment service and unemployment insurance (UI) programs, respectively. These reviews have improved SWA real property management procedures, and increased compliance with OMB Circular A-102 "Common Rule" property management requirements, which appear in DOL regulations at 29 CFR 97.31. SWA real property is also referred to as state employment security agency (SESA) real property in the OIG review reports and elsewhere.

OIG did a comprehensive review of DOL equity in SESA real property in 1988. OIG found instances of inadequate property records and instances where states had reduced or terminated W-P and UI utilization of real property without compensating DOL for its equity, or compensating state accounts in the Unemployment Trust Fund for Reed Act equity in the property. The review led to the development of a SESA real property reporting system and the issuance of GAL 5-94, dated January 24, 1994, which provided comprehensive guidance on the acquisition, use, and disposition of real property involving the use of Reed Act, W-P, and UI funds. (See sections 7 and 8 of this TEGL for a discussion of equity and the amortization arrangements that gave rise to equity.)

In 2001, OIG reviewed shared facility arrangements between one SWA and several WIA local workforce investment boards (LWIBs) within the state. The review report disclosed that enactment of WIA solved some SWA real property problems but also created new problems. The principal new problem was the proper allocation of occupancy costs when properties acquired in whole or in part with Reed Act funds, W-P grant funds, or UI grant funds are occupied by other One-Stop partner programs. In response, this TEGL provides guidance on the proper treatment of costs, interpretations of Federal law affecting the allocation of space occupancy costs in SWA buildings used for One-Stop purposes, and related matters based in part on the resolution of OIG's findings. This TEGL also discusses several other issues with an impact on real property management and real property financing arrangements. In particular, due to revisions to OMB Circular A-87 on June 9, 2004, amortization arrangements will no longer be approved by ETA. Section 15 contains a more detailed discussion regarding the discontinuation of amortization arrangements.

6. Allowable Premises Costs for One-Stop Buildings. Under Federal cost principles, allowable premises costs for grantee-owned buildings are limited to depreciation or use allowances, allocable interest cost, and operation and maintenance (O&M) costs. (See, for example, OMB Circular A-87, Attachment B, item 25, Maintenance, operations, and repairs.) These costs, which are collectively referred to in this TEGL as Allowable Premises Costs, represent only the costs of occupying space in a building. They do not require prior approval by the awarding agency in order to be allowable. Allowable depreciation must be based on the true useful life of the building and not on a period over which the building cost is being amortized. The cost of land cannot be recovered as Allowable Premises Costs because the Federal cost principles do not specifically allow land cost and it is specifically excluded from the calculation of depreciation or use allowances.

Under OMB Circulars A-87 and A-122, which apply respectively to governments and non-profit organizations, the cost of acquiring buildings and other real property is covered under the "equipment and other capital expenditures" category, which treats such acquisitions, including the related land costs, as "unallowable as direct charges, except where approved in advance by the awarding agency." (See OMB Circular A-87, Attachment B, item 15 and OMB Circular A-122, Attachment B, item 15.) Such costs are specifically authorized in the W-P regulations and the UI State Quality Service Plan if incurred under a Reed Act amortization arrangement. However, the regulations for WIA and several other One-Stop partner programs generally require such costs to be treated as unallowable costs. (See 20 CFR 667.260.) Where capital expenditure costs for real property are unallowable, Allowable Premises Costs can be charged to grant funds for the use of property but the excess of either "amortization plus O&M costs" or "capital lease amount plus O&M costs" over Allowable Premises Costs must be paid from non-Federal funds. This issue is further discussed in section 9.

7. **SWA Amortization Arrangements Prior to WIA.** The most common arrangement used by SWAs to acquire office buildings and other real property prior to the enactment of WIA was for a state to buy or construct a building using Reed Act funds. Reed Act funds are distributions of excess funds in the Unemployment Trust Fund (UTF) to the states' accounts in the UTF under Section 903 of the Social Security Act. Reed Act funds may be used to pay unemployment benefits. Alternatively, Reed Act funds may be appropriated by a state legislature for "the administration of its unemployment compensation law and public employment offices," including the acquisition of office buildings. The state may then "amortize" (repay) the Reed Act funds used to buy a building using W-P and/or UI grant funds deposited into its UTF account over a period of years, much like a mortgage repayment.

Reed Act moneys may be used only for the payment of Unemployment Compensation (UC) benefits or the administration of the state's UC law and public employment offices. A state's use of W-P and UI funds to "acquire" property via amortization arrangements created DOL equity in the property. Over time, the state completely repaid its UTF account the Reed Act funds used to buy the property. In effect, Reed Act funds were used as the initial capital of a revolving fund for acquiring buildings for the W-P and UI programs. Reed Act funds used to acquire buildings were replenished with W-P and UI funds, enabling the Reed Act fund source to be used again for additional property acquisitions or for other Reed Act purposes.[1]

8. **Grantor and Grantee Ownership Interests in State-Owned Real Property Acquired With Federal Grant Funds.**

Title distinguished from equity. Title to real property is not the same thing as equity in the property. In most of the arrangements discussed in this TEGL, a state is the owner of a building, i.e., it holds legal title to the building. Where real property is subject to a Reed Act amortization, the state retains title to the property being amortized. The extent of this interest, i.e., legal title, is undiminished throughout the amortization period and afterward. The significance of the state's use of W-P/UI grant money to fund such an amortization is that the Federal government is entitled to repayment of its equity in the property in the form of a percentage of the proceeds from any disposition of the property.

What is equity and how is equity created? While the state usually holds legal title to state-owned real property (the buildings) housing One-Stop programs, both the Federal and state government may have equity in the property. Federal equity is the Federal government's legal interest in a piece of non-Federal real property (see discussion in section 9) resulting from the use of grant funds by the grantee/owner of legal title to acquire the property. Historically, DOL has referred to the process of using W-P and UI grant funds to repay Reed Act or other non-Federal funds used to acquire the property as "amortization." If One-Stop partner programs' funds other than W-P and UI funds are used for amortizing a SWA building, the other partners' grantors obtain equity in the property proportionate to their contributions.

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[1] Sec. 903(c) only authorizes states to appropriate distributed amounts. If the proceeds from the sale or other disposition of property in which there is Reed Act equity includes a "profit", the profit component of the proceeds may not be appropriated for administrative expenditures and must be used for the payment of UI benefits.

How is equity affected by a Reed Act amortization? Initially, the state obtains 100% equity by using Reed Act or other non-Federal funds to purchase the building. Over time, the value of the state's equity declines as the value of Federal equity increases, in proportion to the use of Federal grant funds to replace the Reed Act funds with which the property was purchased. If all non-Federal funds used to acquire the property are repaid with Federal grant funds, the state has no equity in the property although it still has legal title.

Capital leases compared with amortization. Capital leases are similar to amortizations in the sense that both involve periodic payments and both involve the transfer of a substantial economic interest by the end of the payment term. Capital leases are commercial arrangements structured in the form of a lease, i.e., periodic payments entitling the lessee to occupy real estate. The purpose of a capital lease is to finance the lessee's purchase of the real estate from the lessor. In a capital lease, title is transferred at the end of the lease term or when the lessee (in this TEGL, the state or SWA) exercises the option to purchase. In an amortization, the final portion of equity subject to the agreement moves from the acquisition fund source - usually Reed Act-to the Federal grantor agency – usually DOL. Payments under both capital leases and amortization arrangements are often characterized as lease payments. Capital leases do not result in the generation of Federal equity unless there is documentation explicitly providing for the use of grant funds to amortize the cost of acquiring the property. See the section entitled 'Payment of "Allowable Premises Costs" in a Reed Act building' below and the discussion of capital leases in section 9 below after Example 1.

Occupancy under both Reed Act and Part 97 requirements. Occupancy of property subject to a Reed Act amortization must satisfy both Reed Act statutory requirements and the applicable grant programs' real property management requirements. For DOL programs, these property management requirements consist of program regulations such as the WIA regulations cited in section 4, and either 29 CFR 97.31 for governmental grantees, or 29 CFR 95.32 for other types of organizations. For other Federal One-Stop partner programs, occupancy is subject to applicable program regulations and real property management regulations.

Equity compared with 29 CFR 97.31 disposition requirements. The disposition requirements in all Federal agencies' administrative regulations are identical or nearly identical to the related DOL regulations. Disposition of real property occurs when the property is sold or when it ceases to be used for activities authorized under a grant program and is used instead for other grantee programs and activities. If property is sold, title is conveyed to the buyer; if property is used for activities other than authorized grant activities, title is retained by the grantee. In both cases, the dollar value of equity in disposed real property is the same as the amount produced using the formula in 29 CFR 97.31(c) for calculating how much the grantee owes the Federal Government if it disposes of real property acquired with grant funds. Dispositions of real property acquired with Reed Act funds but not amortized with grant funds are not subject to 29 CFR 97.31(c) requirements.

Payment of "Allowable Premises Costs" in a Reed Act building. Documentation of amortization arrangements should clearly indicate that the objective is to amortize the purchase of property, not just to pay for the occupancy of the property. The objective of an amortization is to enable the state to buy property; the objective of paying Allowable Premises Costs is to compensate the state for the use of the property for grant program purposes. If available documentation does not clearly indicate that payments for premises costs were intended as amortization of acquisition costs, ETA will presume amortization was not intended if the amount of such payments did not exceed Allowable Premises Costs for the period during which they were made. In such cases, the payments will be treated as Allowable Premises Costs and DOL obtains no equity in the affected property. Grantees should be cognizant of the fact that the depreciation component of Allowable Premises Cost is a function of the useful life of the property and is therefore unlikely to be equal to amortization payments.

Issues Covered by OIG's Review

9. WIA One-Stop Partners' Occupancy of Space Under Existing SWA Amortization Arrangements.

WIA Sec. 193. WIA Section 193(a) authorizes the governor of a state to make SWA buildings available for use by the WIA One-Stop system. Section 193(b) limits the use of W-P and UI grant funds thereafter for such buildings to paying operation and maintenance costs and to acquiring more equity "*in proportion to the extent of the use of such property*" for W-P and UI activities. Many states had W-P and UI amortization arrangements underway on SWA buildings when WIA was enacted. Questions arose soon after WIA implementation about how to allocate space occupancy costs to One-Stop partner programs other than W-P and UI when such programs began to occupy space in a SWA building, particularly one being amortized, and W-P and UI occupancy decreased. WIA and some other One-Stop partner programs do not permit grant funds to be used for buying real property, including purchases by means of amortization. The WIA prohibition appears at 20 CFR 667.260 in the WIA regulations, and is reproduced in its entirety as Attachment II of this TEGL.

GAL 5-94, which was in effect prior to WIA's enactment, said that if W-P or UI equity utilization decreased below its share of equity, its amortization charges had to stop. For example, if the original occupancy and cost shares in a building were 60% UI and 40% W-P but the occupancy changed during the course of amortization to 50%W-P and 30% UI and 20% other programs, UI would have to stop making amortization payments when its total payments reached 30% of the property's cost. If the occupancy change was significant and permanent, UI equity in excess of 30% would have to be repaid because a significant and permanent change in occupancy is in effect a disposition. This principle would apply to facilities that remained idle longer than temporarily – normally up to a year.

If a One-Stop partner program occupying former W-P or UI space paid less than its full fair share of amortization charges, it would be impossible to repay the original funding source. The state whose shared facility arrangements were reviewed by OIG in 2001 (see section 5) solved this problem by having LWIBs pay only for their share of O&M costs. The remaining premises costs, consisting of the full amount of amortization cost and the W-P and UI shares of O&M costs, were charged to W-P and UI funds.

OIG's recommendation. OIG concluded that the state's shared facility arrangements were inconsistent with WIA on the basis that the Act does not authorize a state to charge W-P or UI grant funds for premises costs allocable to partner programs other than W-P and UI. OIG recommended that the state's W-P and UI programs pay the same proportion of a property's amortization cost as the W-P and UI proportionate share of occupied space in the property. ETA concurs with OIG's analysis of the statute and its recommendation, and notes that this methodology results in an equitable distribution of costs.

Under this methodology, if either W-P or UI activities occupy less space in a building being amortized than their proportion of equity, the state must cease using W-P and UI funds for making further amortization payments and recover any excess payments made after One-Stop occupancy of the property began. Recovered excess payments made from current grant funds may be applied against other current grant costs; the balance of the excess must be applied as directed by the disposition instructions issued in accordance with the applicable administrative requirements regulations. The remaining One-Stop partners must make amortization payments proportionate to their share of the space in a building they occupy. If there are any restrictions on a partner program(s) making such payments, as is the case with WIA funds under 20 CFR 667.260, some other means must be found to pay for the space the program(s) occupies.

We discuss several measures for funding joint One-Stop costs in the resource sharing guidance published in May 2001 (Resource Sharing for Workforce Investment Act One-Stop Centers: Methodologies for Paying or Funding Each Partner Program's Fair Share of Allocable One-Stop Costs, 66 Fed. Reg. 29638, May 31, 2001). One of these measures is paying (or being credited with the payment of) more than a fair share of certain costs such as premises costs in exchange for paying less than a fair share of other costs. Expanded operational guidance may be found in the One-Stop Comprehensive Financial Management Technical Assistance Guide, issued in 2002 and accessible at ETA's Web site at http://www.doleta.gov/sga/pdf/FinalTAG_August_02.pdf

Amortization vs. Allowable Premises Costs. Even where SWAs must change their cost recovery practices to comply with the premises cost allocation approach recommended by OIG, the additional cost burden is less severe than it might appear to be. This is because the generally applicable allowable cost standards for space occupied in a grantee-owned building provides that Allowable Premises Costs, i.e., costs allowable *without* prior approval, consist of either depreciation cost or an annual use allowance[2] of two percent of the building's acquisition cost, allocable interest cost (if any), and O&M costs in all circumstances. (See OMB Circular A-87, Attachment B, items 11, 23, and 25.) Thus, the additional cost of one method vs. the other, if any, is only the difference between the amortization amount plus O&M costs on the one hand and Allowable Premises Costs on the other. The following example illustrates the application of each method.

Example 1 Comparison of SWA Amortization and Allowable Premises Costs Methods

Assumptions

Project financing provided by Reed Act funds

Land Cost	$ 250,000
Building Cost	$ 750,000
Total Cost	$1,000,000
Yearly O&M Cost	$ 35,000

[2]The use allowance computation must exclude land cost. (See Circular A-87, Attachment B, sec. 11(c).) Use allowances may be charged for fully depreciated buildings provided combined use allowances and depreciation previously charged to Federal programs do not exceed the Federal share of the cost of the building. See Circular A-87, Attachment B, item 11(g).

	Annual Premises Costs		
		Allowable Premises Costs	
	Amortization Basis	**Depreciation Basis**	**Use Allowance Basis**
Period	30 years	40 years	Indefinite
Calculation	Total cost ÷ 30 yrs	Bldg cost ÷ 40 yrs	2%/yr. x bldg cost
Annual Amt	$33,333	$18,750	$15,000
+ O&M Cost	$35,000	$35,000	$35,000
Total Annual Cost	$68,333	$53,750	$50,000

In this example, if the total cost of land and building is being amortized over a 30-year period, the total annual premises cost is $68,333 [O&M cost of $35,000 + amortization cost of $33,333 (30 year amortization totals $999,990 plus $10 for rounding)]. If there is no amortization, total Allowable Premises Costs are O&M plus depreciation. Using a 40-year depreciation period for the property based on the building's expected useful life; the annual cost is $53,750 ($35,000 O&M + $18,750 depreciation). Under the amortization methodology, the full $1,000,000 cost of land and building is recovered. Under the depreciation methodology or the use allowance methodology, only the $750,000 cost of the building is recovered. If interest costs were incurred, the result would be the same under the amortization, depreciation, or use allowance methods since all three would provide for full recovery of such costs over the term provided in the financing agreement if the costs were incurred in accordance with OMB Circular A-87.

Capital leases. Some SWA amortization arrangements involve the use of capital leases, variously referred to as a lease with option to purchase, a rental-purchase arrangement, or a lease-purchase arrangement. Many of the properties covered by the OIG review were subject to commercial lease/purchase agreements. In a lease/purchase arrangement, payments by the lessee are designated as lease payments, but at the end of the lease, the lessor transfers title to the property to the lessee. Under Generally Accepted Accounting Principles (GAAP), a lease/purchase arrangement is one of several types of arrangements called capital leases. [See Statement of Financial Accounting Standards (SFAS) 13, Government Accounting Standards Board (GASB), at http://www.fasb.org/st/] The purpose of a capital lease, like that of a purchase money mortgage, is to finance the purchase price of property over time.

When a state chooses to acquire a building using a capital lease arrangement, OMB Circular A-87 limits the amount of allowable capital lease costs to the total of allocable interest costs and either depreciation or use allowances. No prior awarding agency approval is needed for such costs and ETA obtains no equity in the property. In effect, grant funds are only charged for the use of the property and not for the acquisition of the property, despite the fact that the grantee is using a capital lease to acquire the property. (See OMB Circular A-87, Attachment B, items 23 and 37.d.) If the capital lease payments charged to a grant exceed allocable interest costs and either depreciation or use allowances, ETA will treat the excess charges as unallowable questioned costs subject to disallowances. However, when the state requests and receives prior awarding agency approval to acquire a building using a capital lease arrangement, as provided in the *Equipment and other capital expenditures* item of OMB Circular A-87, Attachment B, item 15(b), ETA will treat the arrangement as a capital expenditure and equity will accrue.

As indicated above, 20 CFR 667.260 prohibits the use of WIA funds to buy or construct buildings except in limited circumstances not relevant here; this prohibition includes the acquisition of such property under capital leases. However, WIA funds may be used for interest costs and either depreciation or use allowances, as provided in OMB Circular A-87. If the lease amount or amortization amount plus O&M costs exceeds Allowable Premises Costs included in such charges, the excess must be paid from non-Federal funds. To the extent such charges to a grant are limited to depreciation or use allowances, allocable interest cost, and O&M costs, the affected partner's Federal grantor agency will not obtain equity in buildings under capital leases because its grantee is not paying to acquire the buildings, only to use them.

Example 2 **SWA Capital Lease, with One-Stop Partner Occupants**

Assumptions: Same facts as Example 1, except there is a rental-purchase agreement with a private developer that was signed after WIA enactment in place of Reed Act financing. Assume that WIA is the only program with a capital expenditure prohibition and the following additional facts:

WIA share of space	20%
SWA share of space (exclusive of WIA)	50%
Other programs' share of space	30%

	Annually	Monthly
Total payment	$ 96,000	$ 8,000.00
Interest cost*	$ 30,000	$ 2,500.00
Depreciation*	$ 18,750	$ 1,562.50
Use Allowance*	$ 15,000	$ 1,250.00

* These are information items for the purpose of this example and not items that would be typically included in a rental-purchase agreement. The rental-purchase agreement will specify the monthly and annual payment amounts.

Breakout of Monthly Amortization Cost Shares Under SWA Capital Lease
(Allocable costs not charged to Federal grant funds in Italics)

	WIA (20%)	Non-WIA SWA (50%)	Other Programs (30%)	Total
Land & Bldg	*$ 555.55*	$1,388.87	$ 833.33	$2,777.75
Interest	$ 500.00	$1,250.00	$ 750.00	$2,500.00
Profit	*$ 544.45*	$1,361.13	$ 816.67	$2,722.25
Total	$1,600.00	$4,000.00	$2,400.00	$8,000.00

The $8,000 total monthly payment consists of amortization of the cost of land and building ($33,333 per year, $2,777.75 per month), interest ($30,000 per year, $2,500 per month), and $32,667 annual profit ($96,000 minus ($33,333+30,000)) for the landlord/developer ($2,722.25 per month). All parties must pay their fair share of the operation and maintenance (O & M) costs

($2916.67 monthly, $35,000 annually) in addition to the costs stated in this breakout that are included in the capital lease agreement.

The SWA pays $4,000 (50% of $8,000) monthly and Other Programs pay $2,400 monthly (30% of $8,000). WIA pays $812.50 monthly, which is less than its $1,600 fair share of monthly rent costs. The italicized amounts above in the WIA column represent unallowable costs included in WIA's fair share of monthly rent costs. The unallowable WIA costs must be paid from non-Federal funds. Note the comparison below of allowable WIA costs and the WIA share of "rent" charges under the rental-purchase agreement.

WIA Monthly Costs and Charges Under the Capital Lease

WIA share of rent payment		$ 1,600.00
Allowable Premises Cost		
Depreciation (20% of $1562.50)	$ 312.50	
Interest	$ 500.00	
Allowable WIA cost		$ 812.50
Unallowable WIA cost		$ 787.50

In this example, the Other Programs and non-WIA SWA programs grantors obtain equity in the property; the WIA grantor does not.

10. **Occupancy of SWA Building Space by Partner Programs.** OIG found a situation in which almost all the space in a fully amortized SWA building had been turned over to a Local Board, which was using the space for Board purposes. This is a practice authorized by WIA Section 193(a), which enables a Governor to authorize the use of SWA buildings (buildings in which the Federal government had equity at the time of WIA enactment, based on the use of W-P, UI, or Reed Act funds) "for the use of a One-Stop service delivery system within the state." It should be noted that the law refers to the One-Stop *system* and does not limit such occupancies to One-Stop *centers*. This provision permits a Governor to allow One-Stop partner programs to occupy space in which there is *any* W-P, UI, or Reed Act equity, without regard to the proportionate shares of space financed by W-P, UI, and Reed Act funds. While this greatly broadens the permissible use of property in which there was equity at the time of WIA enactment, it does not extend to real property newly acquired after WIA enactment, in whole or in part with W-P, UI, or Reed Act funds.[3]

Occupancy by partner programs in SWA buildings under Section 193(a) may not be on a cost-free basis. There is nothing in Section 193 which waives the otherwise applicable allowable cost requirements. Section 193(b) is consistent with OMB Circular A-87 insofar as it limits the use of W-P and UI funds to specified costs in proportion to the use of the property for W-P and UI purposes. However, if a state wanted to charge One-Stop partners "rent", the amount of rent charged to Federal grant recipients and subrecipients may not exceed the allowable costs indicated above. Market rent may only be charged to organizations that are non-Federally funded.

[3] An exception may be authorized in the case of a transfer of equity into state-owned property acquired after WIA enactment from property acquired before WIA enactment in which there was W-P or UI equity.

11. Use of Proceeds From Sale or Other Disposition of Property In Which There Is W-P or UI Equity. ETA permits states to use resources obtained from the disposition of property no longer used for W-P and UI purposes to make capital expenditures for W-P and UI property. Such resource transfers, and the related transfers of equity, are made in accordance with the replacement property provision of 29 CFR 97.31. These capital expenditures and equity transfers must be approved by ETA and reflected in SWA real property reports submitted to ETA (see section 16).

The W-P and UI programs have always been statutorily separate programs. (See the U.S. Attorney General's Opinions at 39 U.S. Op. Atty. Gen. 229 (1939) and 39 U.S. Op. Atty. Gen. 296 (1939), which specifically require accounting for and using W-P and UI administrative funds separately, each for its own program purposes.) Several states have cash on hand from the sale of SWA buildings that they are not able to use for replacement property needed for W-P, UI, or One-Stop purposes because the proceeds did not come from the program that needs the space. The replacement property provision in the property disposition requirements at 29 CFR 97.31(c)(1) provides:

> ". . . However, in those situations where a grantee or subgrantee is disposing of real property acquired with grant funds and acquiring replacement real property *under the same program*, the net proceeds from the disposition may be used as an offset to the cost of the replacement property." [italics supplied]

Where the W-P and UI programs' share of space in replacement property differs from their proportionate shares of the disposition proceeds from replaced properties, one of the program's share of sale proceeds may not be sufficient to acquire its share of space in a replacement building, while a portion of the other program's share of sale proceeds has to be returned to the U. S. Treasury. Disposition proceeds, including proceeds from retained property, should be forwarded to DOL for deposit into the U.S. Treasury as soon as received. Proceeds may be retained temporarily – normally up to one year - for acquiring replacement property.

Issues Not Covered in OIG's Review

12. WIA-Funded Repairs, Renovations, Alterations and Capital Improvements to Property. ETA has received numerous questions on the treatment of repairs, renovations, alterations, and capital improvements to property using WIA funds since the issuance of the WIA regulations in August 2000. 20 CFR 667.260, the provision in question, states that WIA funds may not be used for the acquisition or purchase of buildings or facilities; but establishes an exception in the case of repairs, renovations, alterations, and capital improvements to, among other things, SESA and JTPA real property transferred to WIA Title I programs. The full text of Section 667.260 can be found in Attachment II of this TEGL.

The preamble to the WIA Final Rule (65 Fed. Reg. 49367, August 11, 2000) sought to clarify the application of this provision to leased and owned office space by first dividing all expenditures relating to real property into current operating costs and capital expenditures and then assigning repairs and alterations to the current operating costs category and assigning renovations and capital improvements to the capital expenditure category. The intent was to treat current operating costs as allowable costs and to treat capital expenditure costs as unallowable costs unless they came within one of the exceptions specified in 20 CFR 667.260(b). The allowable exceptions specified in that regulation are the costs of repairs, renovations and capitol improvements of SESA real property, JTPA owned property that was transferred to WIA, Job Corps facilities and the funding of disaster relief employment projects.

a. *Current operating costs (repairs and alterations)*. The cost categories "repairs and alterations" in 20 CFR 667.260(b) are covered by two cost categories in OMB Circular A-87 - *Maintenance, operations, and repairs* and *Rearrangements and alterations*. For both categories, the costs are allowable regardless of whether the property is owned or rented.

Maintenance, operations, and repairs covers repairs and alterations to real property. It provides that the costs are allowable without prior awarding agency approval to the extent that they keep the property in efficient operating condition and do not add to its permanent value or appreciably prolong its useful life. (OMB Circular A-87, Attachment B, Item 25). OMB Circulars A-21 (educational institutions) and A-122 (non-profit organizations) have cost provisions covering *Maintenance and repair costs* that are substantially the same as the A-87 provision.

All three OMB cost circulars cited above also have a provision on *Rearrangements and alterations* (OMB Circular A-87, Attachment B, Item 35.). Such costs relate to changes in the interior arrangements within a building rather than the upkeep of the building itself or capital improvements to a building. The costs of ordinary and normal rearrangements and alterations (i.e., within the grantee's normal business practices) are allowable costs; costs incurred specifically for a Federal award, (i.e., beyond the grantee's normal practices) are allowable with prior approval.

b. *Renovations and Other Capital Improvements*. While 20 CFR 667.260 refers to renovations, neither the regulation nor any of the three OMB cost circulars define the term. However, all three OMB cost circulars characterize costs that increase the property's value or prolong its useful life as capital expenditures. Measured by this standard, renovations and the costs of other capital improvements to real property owned or leased by grantees or subgrantees clearly belong in the capital expenditures category. As such, the costs are unallowable unless they come within one of the exceptions specified in 20 CFR 667.260(b) and then only as direct charges approved in advance by the awarding agency.

13. Prior approval of Capital Expenditures for Real Property. Beginning with Program Year (PY) 2002 grants, a clause has been inserted in Wagner-Peyser grant agreements requiring SWAs to obtain DOL prior approval for real property capital expenditures. This is consistent with the *Equipment and other capital expenditures* item of OMB Circular A-87, which requires prior awarding agency approval to be obtained for acquisitions of equipment and other capital expenditures. This item covers buildings, land, and improvements to buildings or land that materially increase their value or useful life. The Wagner-Peyser regulation at 20 CFR 652.8(d)(2) delegates all prior approval for purchases of equipment and other capital expenditures to the states unless DOL chooses to exercise this power after advance notification. The clause inserted in the PY 2002 and later grants exercises this power.

The UI State Quality Service Plan (SQSP) administrative assurances delegate prior approval for the purchase of equipment to the state but never delegated prior approval for real property purchases and other capital expenditures. The special conditions in the Trade Adjustment Act (TAA) grant agreement require DOL prior approval for the use of Trade Act funds for real property capital expenditures. Thus, SWAs need to obtain prior approval from DOL for any acquisitions of real property or capital expenditures involving real property with W-P, UI, or TAA funds.

14. Improvements to Leaseholds. ETA has received many questions about capital expenditures involving leased property used for ETA-funded programs. Usually, such improvements are the responsibility of the landlord since, by definition, they increase the value or useful life of the landlord's property. The landlord ordinarily recovers the cost of the improvement by increasing the rent. We suggest that grantees' requests for office space needed for grant program purposes should include the specification of all necessary features, making it unnecessary for grantee/tenants to make such improvements themselves.

ETA also recognizes that there will be situations in which a landlord is unwilling or unable to make needed capital improvements/renovations to leased premises and it is impractical or infeasible to obtain alternative space. In such situations, capital expenditures for improvements to rented premises (capital improvements) are allowable as direct costs if all of the conditions in paragraphs a. through d. are satisfied. Where feasible, grantees should also seek a rent reduction that reflects the increased value of the landlord's property due to such grantee-financed capital improvements.

a. The expenditure is an allowable cost of the program sought to be charged;
b. The expenditure is classified as an allowable capital expenditure cost under the grantee's financial policies;
c. A cost benefit analysis comparing the total cost of the proposed lease and capital improvement over the lease period compares favorably with alternative arrangements for obtaining comparable space in the locality; and
d. Awarding agency approval is obtained if necessary.

OMB Circular A-87 authorizes Federal agencies to waive or delegate the approval requirement for capital expenditures. ETA is using this authority to waive awarding agency approval for capital improvements to SWA-occupied buildings under $100,000 that are subject to OMB Circular A-87. No Federal equity is created by capital expenditures for improvements to rented premises unless explicitly provided in a written agreement between DOL and the grantee.

15. Phase-out of Amortization Arrangements. On May 10, 2004, OMB issued changes to the three allowable cost circulars, A-21, A-87, and A-122, applicable respectively to educational institutions, governmental organizations, and non-profit organizations. These changes were mainly intended to make the treatment of the selected cost items consistent in all three circulars without making substantive changes. However, a substantive change was made to the capital expenditure item in OMB Circular A-87 that affects SWA building amortization arrangements. Section 15.b.(4) provides as follows:

> *When approved as a direct charge pursuant to Attachment B, section 15.b.(1), (2), and (3), capital expenditures will be charged in the period in which the expenditure is incurred, or as otherwise determined appropriate and negotiated with the awarding agency. In addition, Federal awarding agencies are authorized at their option to waive or delegate the prior approval requirement.*

The circular defines "capital expenditure" at 15.a.(1) as follows:

> *``Capital Expenditures" means expenditures for the acquisition cost of capital assets (equipment, buildings, land), or expenditures to make improvements to capital assets that materially increase their value or useful life. Acquisition cost means the cost of the asset including the cost to put it in place . . . .*

ETA's claim of equity [or compensation for property dispositions under 29 CFR 97.31(c) or 29 CFR 95.32(c)] arising under current amortization arrangements for SWA buildings is based on the concept that each payment of grant funds under the amortization plan is, in effect, a capital expenditure. Over the course of a 20-year amortization plan, there would be 240 such expenditures for each fund source. The newly revised OMB Circular A-87 capital expenditure provision places the capital expenditure and the allowable charges in a single financial period, the period in which the acquisition occurs. Unless the exception clause of this provision is invoked, grant funds could no longer be used for charges under amortization plans in excess of Allowable Premises Cost and no further equity would be created.

The ETA will not approve any new amortization plans; it will invoke the exception clause for existing amortization arrangements on a case-by-case basis. Every existing amortization plan in which the charges exceed Allowable Premises Cost must be submitted for Grant Officer review. The ETA will negotiate with each affected grantee and will issue a determination indicating how long excess amounts will continue to be treated as allowable cost under each plan. Determinations will be based on the length of time remaining in each plan and the difference between total payments due under the plan and the Allowable Premises Cost for the plan period. No determination will provide for an exception period longer than five years. Affected grants will be modified to reflect the determinations.

16. Action Required. ETA grantees and subgrantees must take appropriate action consistent with this TEGL. SWAs must immediately examine their real property procedures, amortization arrangements, and charges to ETA grants for premises costs involving the use of W-P, UI, and Reed Act funds. States must update their SWA real property records to reflect current accurate information on the costs of land, buildings, improvements and interest as well as the fund sources used for acquisition. States must also update, as necessary, the amortization schedule. To the extent these procedures, arrangements, or charges are inconsistent with policies stated in this TEGL, they must be brought into compliance not later than December 31, 2004.

17. Inquiries. Questions should be addressed to the appropriate ETA Regional Office.

GLOSSARY OF TERMS AND ACRONYMS

Allowable premises costs – as used in this TEGL, collective term for costs that are allowable without prior awarding agency approval (see section 6)
Amortization – as used in this TEGL, use of grant funds for periodic repayments of another fund source that supplied the funds for buying buildings or other real property (see sections 7 and 8)
Awarding agency – in the case of grants, the DOL or other Federal granting agency; in the case of subawards, the party making the subaward
Capital improvement – expenditure which results in an increase in the value or useful life of a long-term asset, e.g., upgrading a building's heating system
Capital lease – financing transaction in the form of a lease entered into in connection with the acquisition of real property or other assets (see sections 8 and 9)
CFR – Code of Federal Regulations
Common Rule – Regulation issued by Federal agencies (DOL – 29 CFR part 97) in response to OMB Circular A-102 establishing administrative requirements for grants to state, local, and Indian tribal governments
Equity – Federal Government's legal interest in grantee-owned property based on the use of grant funds to acquire the property (see section 8)
Fed. Reg. – Federal Register – Daily publication containing notices and rules issued by the administrative branch of the U.S. Government
GAL – General Administrative Letter 5-94 – ETA administrative directive to SESAs issued in 1994 concerning SESA property
OIG – Department of Labor Office of the Inspector General
Leasehold – leased real property
Maintenance and Repairs – expenditures for keeping property in suitable operating condition without adding to its value or prolonging its useful life
OMB Circular – Directive issued by the Office of Management and Budget to DOL and other Federal agencies
Prior Approval – documentation evidencing consent of the awarding agency prior to incurring a specific cost
Rearrangements and Alterations – changes in a building's interior space arrangements or utilities that neither add to its value or prolong its useful life
Reed Act – Section 903 of the Social Security Act, that authorizes states to use certain funds in their Federal Unemployment Trust Fund accounts for W-P and UI grant costs
Renovation – major improvement(s) to existing building that increase its value or prolong its useful life (see section 13)
SESA – State Employment Security Agency – term formerly used for SWAs
SWA - State Workforce Agency – state agency that administers the W-P and/or UI programs
Title III of the Social Security Act (SSA) – See UI
UI – Unemployment Insurance program authorized by Title III of the Social Security Act (42 U.S.C. 501-504) that provides grants to states for the costs of administering their UI laws
U.S.C. – United States Code – U.S. laws in codified format
Wagner-Peyser Act (W-P) – also called Job Service or Employment Service program - Act (29 U.S.C. 49d-49l) authorizing grants to states for operating their systems of public employment offices

Sec. 667.260 May WIA title I funds be spent for construction?

WIA title I funds must not be spent on construction or purchase of facilities or buildings except:

(a) To meet a recipient's, as the term is defined in 29 CFR 37.4, obligation to provide physical and programmatic accessibility and reasonable accommodation, as required by section 504 of the Rehabilitation Act of 1973, as amended, and the Americans with Disabilities Act of 1990, as amended;

(b) To fund repairs, renovations, alterations and capital improvements of property, including:

(1) SESA real property, identified at WIA section 193, using a formula that assesses costs proportionate to space utilized;

(2) JTPA owned property which is transferred to WIA title I programs;

(c) Job Corps facilities, as authorized by WIA section 160(3)(B); and

(d) To fund disaster relief employment on projects for demolition, cleaning, repair, renovation, and reconstruction of damaged and destroyed structures, facilities, and lands located within a disaster area. (WIA sec. 173(d).)