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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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OCT 21 1975

The Honorable Carl T. Curtis
United States Senate

Dear Senator Curtis:

As your November 1, 1974, letter requested, we examined the lease transaction between Nebraska's Department of Labor and the Jado Investment Company. You indicated concern over the fact that no competitive bidding was involved and suggested that, if Federal regulations were followed, they may need strengthening to encourage competitive bidding.

We examined Federal and State legislation and regulations related to leasing privately owned space for the State's employment security agency. We also reviewed information pertinent to the lease transaction. We discussed the matter with officials of the Department of Labor's Manpower Administration and its Kansas City regional office, the General Services Administration, and the Nebraska Department of Labor.

Department of Labor regulations provide that States may lease space (1) through competitive bidding, (2) on the basis of a comprehensive survey of available space, or (3) in accordance with Department-approved State practices. The lease with the Jado Investment Company was entered into in July 1971, on the basis of a comprehensive survey of available space in the Omaha area.

Labor Department regulations require a State to have a comprehensive survey made and the results reported to the Department for approval of the expenditure of Federal grant funds. The information in the comprehensive survey for the Jado lease was obtained through a partner of Jado and was not independently verified by State personnel. Although the survey information appears to be correct, we are recommending to the Secretary of Labor that regulations be revised to require that surveys used in negotiated leases be made by independent parties. From information we obtained on prevailing rents in the Omaha area, the rate for the Jado lease appears reasonable.

In January 1973 Federal standards were established for leasing space with grant funds provided to State and local governments. They require formal, competitive bid procedures

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unless unfeasible. We are recommending to the Secretary of Labor that the regulations be revised to incorporate these standards.

BACKGROUND

Labor Department regulations require State agencies to comply with Manpower Administration fiscal standards set forth in part IV of the Employment Security Manual. Section 2510, part IV, authorizes a State to use Federal grant funds to rent privately owned space for its employment security program. It further provides that the space must be leased (1) through competitive bidding, (2) on the basis of a comprehensive survey, or (3) in accordance with Department-approved State practices. A comprehensive survey must contain data on enough suitable and available locations to clearly indicate that the rental rate of the proposed space is comparable to prevailing rates for other suitable and avialable spaces in the area.

If the survey does not contain enough suitable, available locations to clearly indicate prevailing rental rates, then data must be provided on enough occupied spaces to demonstrate the rental rates of comparable space. Before leasing space, a State is also required to obtain approval from the Department's regional director on the location of the space and the expenditure of grant funds.

NEBRASKA-JADO LEASE TRANSACTION

In the latter part of 1970, the Kansas City regional office reviewed Nebraska's employment security operations. It reported to the State that space problems in Omaha were particularly acute and recommended that space requirements be promptly reviewed.

The Nebraska Commissioner of Labor in January 1971 visited employment security offices in Omaha and found critical space problems. He concluded that operations in three separate offices some distance from each other should be consolidated into one office to achieve greater efficiency.

In May 1971 the regional office approved the expenditure of funds to rent space in a building to be constructed by Jado. The State's request for Federal funds was supported by a comprehensive survey, which included estimated rental rates and lease provisions for the proposed Jado building and for two alternative buildings that had not yet been constructed.

The annual rental of the Jado building was estimated at $5.66 per square foot, while the estimated rentals for the other buildings were $5.68 and $5.46 per square foot. Although the rate for one of the alternative buildings was slightly lower, the proposal did not include carpeting, insurance, and major maintenance, as did the Jado proposal.

Similar data was submitted for seven occupied buildings. Rental rates ranged from $4.35 to $6.50 per square foot. Although certain of the rental rates were below Jado's proposed rate, these buildings generally provided only limited offstreet parking. Also, the lower rates were generally for upper level floors, whereas the Jado proposal was for all three floors of the building.

The State's Commissioner of Labor certified that the space in the proposed Jado building was suitable for the employment security agency and that the rental rate was comparable to rates for other suitable space in the same locality.

Nebraska entered into the lease agreement with Jado in July 1971 and occupied the building in August 1972.

Jado provided data for comprehensive survey

The data on prevailing rental rates in the comprehensive survey which the State submitted was obtained from a partner of Jado and was not verified by State personnel.

We were unable to determine from the limited information in the State's comprehensive survey file the amount of survey work performed. The official responsible for obtaining the Jado space had retired.

We interviewed the retired official, who told us that a heavy workload at the time prevented his office from making the survey. He therefore asked a partner of Jado to obtain the information--rental rates and other lease provisions--on several proposed and existing buildings. The former State official told us that he did not verify the data received.

The Nebraska Appropriations Subcommittee on Leasing investigated the Jado lease transaction in the latter part of 1974. The Jado partner testified that he obtained rental rates and related data for the two proposed alternative buildings from a Commissioner of Douglas County, Nebraska, and for seven existing buildings from a licensed real estate broker and appraiser in Omaha.

The Douglas County Commissioner said he obtained his information from inquiries made of builders in early 1971 in connection with a survey he made for office space for Douglas County. The County's records showed that information obtained by the Commissioner was identical with the rental rates for the proposed buildings reported in the comprehensive survey.

The Omaha realtor stated that the information on the seven existing buildings was obtained from the various building managers. Although he did not recall the exact details for each building, he generally recognized the rental rates shown on the comprehensive survey as those which he furnished to the Jado partner.

Regional office review of lease transaction

In 1970 the Manpower Administration issued to regional offices guidelines for reviewing the States' expenditure of Federal grant funds to lease privately owned space.

The guidelines call for determining the need for and the adequacy of the new space for employment security operations, as well as determining whether the rental rate for the new space is in line with rentals in the area. In examining the rental rates in the comprehensive survey, the regional office is to assure itself that (1) all rates are based on the same space factors, (2) the square foot rate of the proposed space does not exceed prevailing rates in the area without adequate justification, and (3) the sizes of the buildings in the survey are similar.

Regional officials told us that they followed informal procedures in reviewing comprehensive surveys and that the office has insufficient staff to independently verify how and by whom the survey is performed and must depend on the States to submit reliable data.

The survey information submitted to the regional office did not indicate that the survey was performed by a Jado partner. Regional officials told us they would have questioned the survey results had they known this fact.

Terms of lease agreement

The basic annual rental for the Jado building is $133,488 and cannot be increased during the 15-year lease. The State also pays real estate taxes, utilities, and building and grounds maintenance. Although the 15-year term is binding on the owner, the State legislature may terminate the lease at June 30 of any year by not appropriating rental funds.

The terms of other leases in the State's comprehensive survey were for 5 years or less, and real estate taxes were included in the basic rental rates. The leases, however, contained escalator clauses for taxes, which required lessees to pay higher rental rates if taxes were increased.

We reviewed State leases for privately owned space in 18 other locations, 2 of which were in Omaha. Most of these leases require the State to pay for utilities and janitorial services, but none require separate payment of real estate taxes. Most of the leases were for terms of 5 years or less and included 1-year cancellation clauses. A State official told us that these lessors considered real estate taxes in establishing the basic rental rates.

State officials said that the Jado lease negotiations were initially based on the assumption that the proposed Jado building would be tax exempt. When this assumption was found to be incorrect, the State agreed to pay real estate taxes to avoid renegotiating the basic rental rate.

According to State officials, the 15-year term of the lease was necessary to give Jado an incentive to invest in construction.

The Nebraska Department of Labor estimated the annual basic rental rate plus taxes and other expenses for the Jado building at about $6 per square foot for fiscal year 1975.

We discussed this annual rental rate and the lease terms for the Jado building with an Omaha realtor and the president of a large Omaha firm which builds and leases office buildings.

They both stated that the cost of the Jado building was reasonable, considering the prevailing rental rates in Omaha and the building's newness.

In November 1974 the Governor of Nebraska requested the Director, Department of Administrative Services, to ascertain whether the State could find less expensive acceptable space, because the State Appropriations Subcommittee on Leasing was concerned about the Jado transaction.

The Governor asked the Director to appoint a committee and suggested that it advertise for proposals for space similar to that occupied and with the same 1-year cancellation clause. Public notices were published in two Nebraska newspapers in December 1974, requesting proposals for suitable office space for employment security operations in Omaha. Five proposals were received; however, only three satisfied the State's requirements.

At the request of a member of the committee, regional officials reviewed the proposals and visited the alternative sites. These officials found disadvantages in each of the proposals, such as (1) location unsuitable for clients served or (2) building unsuitable for employment security operations.

The committee recommended that the Governor take no further action to relocate for fiscal year 1976, as there was no justifiable alternative to the existing Jado lease.

CHANGES IN FEDERAL AND STATE PROCEDURES

Since the Jado lease was signed in July 1971, the Federal Government and the State of Nebraska have established new procedures for leasing space with Federal grant funds.

To implement the Intergovernmental Cooperation Act of 1968 (42 U.S.C. 4201 *et seq.*), the Office of Management and Budget issued standards--Circular A-102, effective July 1, 1972--for establishing uniformity among Federal agencies administering grants to State and local governments. Attachment O to this circular, effective January 1, 1973, provided standards to be used by State and local governments when making procurements with Federal grant funds, including the purchase of leased space. This circular applied to all grants made by Federal agencies to State and/or local governments unless enabling legislation for specific grant programs differed from the circular or the Federal agency was granted an exception.

Standards were established to insure that leases are made in an effective manner and conform to Federal law. They require (1) obtaining leases in a manner that affords the most open and fair competition and (2) formal advertising with adequate description, sealed bids, and public openings. However, if formal advertising is impractical, leasing may be accomplished by negotiation.

In September 1974, as a result of the transfer of functions covered by Circular A-102 from Office of Management and Budget to the General Services Administration, the circular was reissued without substantive changes as Federal Management Circular 74-7.

The leasing standards in the original circular were to be applied by January 1, 1973. We discussed this matter with Manpower Administration officials on June 6, 1975, and they agreed to amend regulations to require formal advertising and competitive bidding whenever possible. As of September 2, 1975, Labor had not amended its regulations to implement the circular's requirement.

The State of Nebraska enacted legislation in April 1975, 1/ to provide that contracts for leases, including State employment security agency leasing of privately owned office space, be subject to competitive bidding. The legislation authorized the establishment of an independent unit to act as the State's purchasing agent. This unit is to receive all lease requests and advertise in the manner calculated to best attract competition. Generally, contracts are to be awarded to the lowest responsible bidder.

Furthermore, the procurement unit's administrator must decide on all proposed leases and file a written report on the reasons for his decision with the Governor and the Executive Board of the Legislative Council.

CONCLUSIONS

Nebraska entered into the Jado lease on the basis of a comprehensive survey of available space in the Omaha area. Labor Department regulations allow a State to use this method to support its request for grant funds to lease space. The

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1/Nebraska legislative Bill No. 359, enacted April 22, 1975.

rental cost of the Jado lease appears reasonable for the area where the building is situated. The lease provision requiring separate payment of real estate taxes by the State and the 15-year term of the lease differed from other leases in the State's comprehensive survey and other State leases we reviewed. Most of these leases were for terms of 5 years or less and included real estate taxes in the basic rental. However, some included tax escalator clauses.

A committee appointed by the Director of the State Department of Administrative Services formally advertised in December 1974 for space similar to that of the Jado building. The committee concluded there was no justifiable alternative to the existing lease for fiscal year 1976.

The comprehensive survey used by the State to obtain Labor Department approval for the payment of Federal funds was not made by an independent party, although the data furnished appears correct.

Since the Jado lease transaction, Federal standards which generally require competitive bidding have been established for leasing space with Federal grant funds. The Department of Labor should amend its leasing regulations to comply with the Federal standards and to provide that, when competitive bidding is not feasible, negotiated leases be based on independent comprehensive surveys. These changes should provide assurance that State agencies lease space at the lowest cost and best possible terms.

RECOMMENDATIONS

We recommend that the Secretary of Labor require the Assistant Secretary for Manpower to promptly amend the Employment Security Manual to (1) incorporate the provisions of Federal Management Circular 74-7 and (2) require that if comprehensive surveys are used in negotiated leasing, they be performed by independent parties.

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We discussed this report with Labor Department officials and their comments and views were considered in preparing the report. However, as you requested, we did not follow our usual policy of obtaining written comments from the Department.

As agreed with your office, copies of this report are being sent to the Secretary of Labor, the Administrator of General Services, and the House and Senate Committees on Government Operations and on Appropriations.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States