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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. [illegible]

B-164031(3)

Dear Mr. Weinberger:

The General Accounting Office has inquired into the manner in which States and local governments acquire facilities to house their welfare operations to determine whether certain provisions of the Office of Management and Budget (OMB) Circular A-67 have adversely affected [illegible] of grantees to choose the most economical method of [illegible]ing space. The provision under consideration is [illegible]. 7. of Attachment B to OMB Circular A-67 which provides that:

> "Interest on borrowings (however represented), bond discounts, costs of financing [illegible] operations, and legal and professional [illegible] in connection therewith, are unallowable [illegible] authorized by Federal [illegible]."

The inquiry was made in June 1971 by [illegible] questionnaires (see enc. I) to 17 selected States and local governments. Our objective was to determine:

--What methods States and local governments used to acquire space (lease or purchase).

--The extent to which each method was used.

--What effect the provisions of A-67 h[illegible] selection of the method used to acquire space.

--Whether the method selected was resulting in the lowest cost to the government.

Of the 17 governments responding to the questionnaire, 12 complete responses (see enc. II) were received. [illegible] from 10 of the 17 State and local governments [illegible] opinion regarding their rationale [illegible] extent to which they made cost comparisons are [illegible] in enclosure III.

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We also inquired into the circumstances whereby OMB and the Department of Health, Education, and Welfare (HEW) previously waived the disallowance of interest to enable cost savings.

RESPONSES TO QUESTIONNAIRE

Respondents showed that leasing from the private sector was the most common method used to acquire space to house welfare activities--974, or 77 percent, of 1,259 welfare offices were leased. Space rentals or amortization for these 1,259 offices were estimated at $53 million for fiscal year 1972.

The respondents listed various reasons (see enc. III) for leasing, rather than purchasing, facilities. Of the 10 respondents on this matter, four cited the overly restrictive Federal Government policy of participation in purchase or construction costs and the interest costs associated with purchasing or constructing facilities as a reason for leasing.

State and local governments generally do not make analyses to ascertain the most economical acquisition alternative (lease or purchase). Some have not undertaken such analyses because they do not consider purchase as a viable alternative in light of the restrictive provisions of Circular A-87.

Although most of the respondents indicated that they usually do not make analyses to determine the most economical method of acquiring space, those that had made such an analysis believed that the cost of purchasing or constructing might be considerably less than that of leasing. These governmental units said they would probably purchase more often if Federal cost-sharing policies were more flexible.

PRIOR WAIVERS OF RESTRICTIONS
ON SHARING INTEREST

On several occasions, OMB and HEW waived interest cost restrictions when State or local governments or other grantees

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2 the Department of Health, Education, and Welfare (HEW) previously waived the disallowance of interest to enable cost savings. 22

RESPONSES TO QUESTIONNAIRE

Responses showed that leasing from the private sector was the most common method used to acquire space to house welfare activities--774, or 61 percent, of 1,259 welfare offices were leased. Space rentals or amortization for these 1,259 offices was estimated at $53 million for fiscal year 1972.

The respondents listed various reasons (see enc. III) for leasing, rather than purchasing, facilities. Of the 10 responding on this matter, four cited the overly restrictive Federal Government policy on participation in purchase or construction costs and the interest costs associated with purchasing or constructing facilities as a reason for leasing.

State and local governments generally do not make analyses to ascertain the most economical acquisition alternative (lease or purchase). Some have not undertaken such analyses because they do not consider purchase as a viable alternative in light of the cost-share provisions of Circular A-87.

Although most of the respondents indicated that they usually do not make analyses to determine the most economical method of acquiring space, two that had made such an analysis believed that the cost of purchasing or constructing might be considerably less than that of leasing. These governmental units said they would probably purchase more often if Federal cost-sharing policies were more flexible.

PRIOR WAIVERS OF RESTRICTIONS
ON CHARGING INTEREST COSTS

On several occasions, OMB and HEW waived interest cost restrictions when State or local governments or other grantees took the initiative to request it and were able to show that cost savings would result. Examples follow.

Oregon

On April 17, 1970, Oregon requested OMB to waive the requirements of A-87 so that the Federal Government could cost-share in a uniform rental rate--including interest costs--for State-owned buildings. The State pointed out that substantial savings would result because the rental rate (including interest) was considerably below that of rental rates for the private sector.

On October 6, 1970, OMB waived the restriction in A-87 and advised HEW to accept the proposed rate, [illegible] Federal sharing of interest costs. In so doing, OMB advised [illegible] that:

"If other situations like this one present themselves in the future, we believe each should be decided on its individual merits, considering the best interests of the Federal Government, and the potential impact upon the State or local government involved."

County of San Francisco

On December 30, 1970, California, on behalf of the county of San Francisco, requested HEW to waive the requirements regarding interest so that the county could purchase space to house its welfare operations. The county provided a comparison showing total estimated savings of $2.6 million by constructing, rather than renting, facilities--the Federal share of savings was estimated at about $1.3 million.

Because of the obvious savings and the prior advice from OMB in October 1970, HEW waived the restriction in A-87 and shared the bond retirement expenses, including interest.

OMB Circular A-21

Although A-21 relates to grants and contracts with educational institutions rather than with States and local governments. It does deal with the unallowability of interest for Federal sharing. Also, as in the case of A-87, OMB has occasionally waived the restriction when it was appropriate for cost savings. For example:

--On September [illegible], 19[illegible], OMB waived the restriction in A-21 and allowed HEW to share interest costs relating to the purchase of computer equipment by the University of California at Los Angeles. The university estimated that [illegible] $[illegible]0,000 could be saved if the equipment were purchased under an IBM installment payment plan rather than rented.

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The Federal Government does not participate in interest costs, except in those instances when State or local governments or other grantees take the initiative to inquire into the most economical method (lease or purchase) of acquiring facilities or equipment and successfully seek a waiver. No guidance from the Federal level encourages them to take this initiative or provides the assurance that, when appropriate, such restrictive provisions as those in A-87 or A-21 can be waived. It seems reasonable to assume that, with increased encouragement, grantees would seek out the most economical methods of acquisition, because it would be to their cost advantage to do so.

We have had several discussions with officials of the Financial Management Branch of OMB regarding this issue. They agreed that neither A-87 nor A-21 permits the flexibility needed to insure that the most economical method of acquisition is considered or used. Further, an HEW official told us that the present restrictive Federal policy regarding interest had resulted in leasing both space and equipment when purchasing would have been more economical.

CONCLUSIONS

Although we do not believe that OMB should undertake a sweeping policy change at this time regarding recognition of interest as an allowable cost, we do believe that:

--Analysis of acquisition alternatives by State and local governments or other grantees affected by A-87 and A-21 would be worthwhile.

--OMB should encourage such analyses.

--Waivers should be granted when they are justified on the basis of valid cost comparisons.

State and local governments or other grantees should give the same recognition to the cost of money and to the taxes foregone as is required of Federal agencies.

RECOMMENDATIONS

Accordingly, we recommend that OMB develop a procedure for granting waivers which will allow recognition of interest and related professional fees (noted in section B. 7. of Attachment B of A-87 and in comparable sections of A-21) as allowable costs when cost comparisons clearly show that it is advantageous.

We recommend that, to insure that such analyses will be equitable and consistent, OMB develop guidelines for use by grantees in making such cost comparisons.

We believe that the criteria in such guidelines could be similar to those in OMB Circular A-104,[1] with certain modifications. Specifically, such guidelines should:

--Include Federal income taxes foregone on leasing income.

--Include Federal income taxes foregone as a cost of purchasing, when State and local tax exempt financing is used.

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[1]Comparative cost analyses for decisions to lease or purchase general-purpose real property (applies only to Federal agencies).

--Provide for using a discount rate (a time value of money measurement) closely aligned with the grantees' actual costs of borrowing or those costs in which the Federal Government will be sharing, rather than the internal rate of return on property leased from the private sector as is prescribed in A-104.

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We shall appreciate receiving your comments on our conclusions and recommendations. We would be particularly interested in being advised of the basic criteria to be used in any guidelines for granting waivers that you would consider implementing, how such guidelines would be implemented, and how OMB would assure itself that Federal agencies and State and local governments or other grantees would be made aware of the increased flexibility available to them in deciding on a method of acquisition.

As previously indicated, we have discussed these matters with members of your Financial Management Branch. We are available for further discussion if you should decide it would be beneficial.

Sincerely yours,

Comptroller General
of the United States

Enclosures - 3

The Honorable Caspar W. Weinberger
Director, Office of Management and Budget

ENCLOSURE I

Control No.

____

UNITED STATES GENERAL ACCOUNTING OFFICE

SURVEY OF [illegible] ACTIVITIES

HOUSING [illegible] OFFICE

QUESTIONNAIRE [illegible]

Questionnaire on Welfare Office Space

1. General

(a) Which department or division determines welfare office space[1] needs?

(b) Which department or division actually obtains the necessary welfare office space?

(c) Whose (Federal, State, etc.) approval is required before welfare space is obtained?

(d) What is your estimated dollar expenditure for welfare office space rentals/amortizations in FY 1971-72?

____

(e) What is the rate of Federal participation in the welfare office space costs?__________percent

2. How many welfare offices are under your department's jurisdiction?________

How many of the offices

(a) are buildings purchased specifically for welfare purposes?_______

(b) are leased?______________

(c) are occupying space in State/County-owned buildings?

____

(d) other, please specify

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[1]Welfare office space may be defined as space to meet the specific needs of administering welfare aid programs, but not including such supportive services as data processing.

3. What financing methods are or have been used to obtain welfare office space? (Please mark those applicable)

   (a) Purchase

      (1) Using appropriated funds ________

      (2) By revenue bonds issued by a nonprofit corporation (NPC)[2] ________

      (3) By revenue bonds issued by a joint powers authority (JPA) agreement[3] ________

      (4) By other type of bond issue, please specify

   (b) Leasing with the private sector ________

   (c) Any other method(s), please specify

4. If NPC financing has been used, is it necessary for the issuing entity to own the land before the bonds may be issued?

5. If JPA financing was used, what entities were parties to the agreement(s)?

6. If welfare office space has been leased from the private sector, please complete the following. If a list or schedule is available that would provide this information

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[2]NPC - a nonprofit corporation set up by a government entity such as a county for the purpose of issuing tax-free revenue bonds to obtain funds for constructing or purchasing office space.

[3]JPA - a legal agreement between two entities, such as county and state governments, which allows issuance of tax-free revenue bonds to secure funds for obtaining land and constructing or purchasing office space.

we would appreciate your including it with the questionnaire in lieu of answering this question.

(a) Lease terms

(1) Number of leases with terms of 20 years or more __________

(2) Number of leases with 3-19 years terms__________

(3) Number of short-term leases, under 3-year terms __________

(4) Number of month-to-month leases__________

(b) Options to purchase

(1) Number of leases with options to purchase at or before the end of the lease term__________

(2) Number of leases with no options to purchase __________

(3) Number of options to purchase exercised in the last 5 years__________

(4) Number of options to purchase expected to be exercised__________

(c) Cancellation clauses

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(1) Number of leases with cancellation clauses __________

(2) Number of leases without cancellation clauses __________

(3) Have any leases ever been canceled?

Yes__________ No__________

(4) If any leases have been canceled, for what reason(s)?

(d) Who pays the following under leasing arrangements, the State/County or the lessor.

(1) Taxes ________

(2) Insurance ________

(3) Alterations and/or addition ________

(4) Maintenance and repairs ________

7. Please list the characteristics if your department has what would be described as a "typical" welfare office

(a) Number of square feet ________

(b) Employee capacity ________

(c) Monthly rental $ ________

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(d) Lease term, months/years ________

(e) Amortization/depreciation charge per month, if other than lease arrangements $ ________

(f) Number of "typical" welfare offices ________

8. What do you estimate as your additional welfare office space needs over the next 5 years?

(a) Number of additional offices ________

(b) Approximate dollar expenditures for the additional offices ________

(c) Method(s) of financing to be used for additional offices (please mark those applicable)

(1) Purchase

(a) Using appropriated funds ________

(b) By revenue bond issued by a nonprofit corporation (NPC)________

(c) By revenue bond issued by a joint powers authority (JPA) agreement________

(d) By other type of bond issue, please specify

(2) Leasing with the private sector__________

(3) Any other method(s), please specify

9. What in your opinion is the most economically advantageous method of financing welfare office space from the standpoint of your organization?

(a) In the event you are not using the method you consider most advantageous; what is preventing you from doing so?

(b) What needs to be done to bring about more extensive use of the method you consider most advantageous?

10. Please use this space for any other comments you care to make.

RECAP OF RESPONSES TO

QUESTIONNAIRES ON WELFARE OFFICE SPACE

Responses from the following 12 jurisdictions were complete and are summarized in this recap.

STATE	COUNTY	CITY
Florida	Los Angeles, California	New York, N.Y.
Hawaii	Denver, Colorado	
Illinois	Fulton, Georgia	
Pennsylvania	Wayne, Michigan	
Texas	Cuyahoga, Ohio	
Washington		

Responses from five States--California, Colorado, Georgia, Michigan, and New York--were not sufficiently complete to be included in the recap.

	Number	Percent
Offices:		
Purchased specifically for welfare purposes	22	2
Leased	874a	69
Occupying space in multipurpose State/county-owned buildings	363	29
	1,259	100
Financing methods used to obtain office space:		
Number of welfare departments out of 12 which:		
Purchased:		
Using appropriated funds	4	33
Using nonprofit corporation (NPC) bonds	1	8
Using joint powers authority (JPA) bonds	-	-
Leased from the private sector	11	92
Leased from the public sector	3	25
Leasing from the private sector:		
Leases:		
Over 20-year term	132	15
3- to 19-year term	437	49
Under 3-year term	273	31
Month-to-month term	42	[illegible]
Total	884a	100

[a] The difference between offices leased and leases is attributable to some offices being covered by more than one lease.

	Number	Percent
Options to purchase	49	6
No options to purchase	835	94
Total	884	100
Options exercised in the last 5 years	2	-
Options expected to be exercised	-	-
Cancellation clauses	311	35
Without cancellation clauses	573	65
Total	884	100
Estimate of additional welfare space needs over the next 5 years:		
Number of additional offices (note b)	181	
Methods of financing to be used for additional offices:		
Number of welfare departments out of 12 planning to:		
Purchase:		
Using appropriated funds	2	17
Using NPC bonds	1	8
Using JPA bonds	1	8
Total purchase	4	33
Lease from the private sector	11	92
Lease from the public sector	1	8
	12	100
Opinions as to the most economically advantageous method of financing welfare office space:		
Purchase	3	
Lease from the private sector	7	
Not stated	2	
Total	12	

[b]Approximate dollar expenditure for the additional offices was $54,764,000.

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RECAP OF LEASING PRACTICES

[illegible]

OF 10 RESPONDENTS

Rationale for leasing

Leasing offers more mobility than purchasing, so offices are not locked into any particular area.

1 city (New York)
2 counties (Fulton, Georgia; Cuyahoga, Ohio)
2 States (Pennsylvania, Washington)

5

Statutes or policies restrict purchase methods but authorize leasing for space acquisition.

3 States (Illinois, Pennsylvania, Washington)
2 counties (Fulton, Cuyahoga)

5

Approval and purchase of space is a long and complicated process, while leases are more easily approved and processed.

4 States (Florida, Illinois, Pennsylvania, Washington)
1 city (New York)

5

Lack of funds for purchasing or constructing office space.

2 States (Florida, Illinois)
1 county (Fulton)

3

Welfare space is politically unpopular and too low a priority to acquire with appropriated funds or general revenue bond issues.

1 state (Michigan)
1 county (Denver, Colorado)

2

An overview of effective federal government policy on participation in purchase or construction costs and the interest costs associated with purchasing or constructing facilities.

3 states (California, Florida, Michigan)
1 city (New York)

4

Cost comparisons

No lease-purchase cost comparisons were made.

3 States ([illegible], Pennsylvania, Washington)
1 county ([illegible])

4

Respondent was not aware of any cost comparisons that may have been made.

1 city (New York)
2 counties (Denver; Wayne, Michigan)

3

Cost comparisons were made and purchase or construction of facilities was found to be more economical.

1 State (Florida)
1 county (Los Angeles)

2

Some cost comparisons had been made but were not readily available.

1 county (Fulton)