**DEPARTMENT OF SOCIAL SERVICES**
744 P Street, Sacramento, CA 95814

October 13, 1998

COUNTY FISCAL LETTER (CFL) NO. 98/99-39

TO: COUNTY WELFARE DIRECTORS
COUNTY FISCAL OFFICERS
COUNTY AUDITOR CONTROLLERS
COUNTY PROBATION OFFICERS

SUBJECT: SPACE COSTS

REFERENCE: County Fiscal Letter 95/96-27, All County Information Notice I-76-85 and All County Letter 88-66

As a result of the implementation of CalWORKs, staff changes, and county reorganizations the Fiscal Policy Bureau (FPB) has received a number of questions regarding claiming requirements for Space costs. The purpose of this CFL is to clarify existing policy and provide counties with information regarding the California Department of Social Services (CDSS) and the State Controller's Office (SCO) role in responding to inquiries about Space costs. The CDSS FPB, in coordination with the SCO County Cost Plans Section, have prepared this CFL to help with your inquiries.

## I. REIMBURSEMENT OF SPACE COSTS

Space costs are usually incurred for the occupancy of a building. They can be costs associated with acquiring or improving the building, or costs associated with building maintenance. Space costs are operating costs and must be distributed to all programs benefiting from occupancy in the building. The building occupied is usually considered either a county-owned building, rented or leased facility. While there are many facets to consider when determining if a facility meets the requirements or guidelines of an owned building or that of rented or leased space, reimbursement is based on this determination.

**Counties are reminded that the Office of Management and Budget (OMB) Circular A-87, rules do still apply to costs funded with the single allocation.**

***Use Allowance/Depreciation***

When the building is a county-owned facility, a use allowance or depreciation is applied when claiming space costs. Use allowance is an annual fixed rate, which does not exceed two percent of the total acquisition cost plus capital improvements. The use allowance method is based on an averaging concept, which implicitly recognizes that certain assets within each broad category have longer lives than average and some shorter. Depreciation is an annual fixed rate based on expected useful life as determined by IRS guidelines and Generally Accepted Accounting Principles (GAAP). All components of a single class of fixed assets must be treated alike. Depreciation or use allowance would have to be taken on all fixed assets in the same class.

***Operating Rent/Lease***

If a building is going to be claimed as a lease/rental cost there cannot be an acquired equity or ownership by the county. Straight lease and rental agreements do not require prior approval by the CDSS, though, the county must maintain comparable rental data on file for audit review. The costs of these rented or leased facilities may be claimed indirectly through the Countywide Cost Allocation Plan (CCAP), or directly on the County Expense Claim (CEC) if paid by the County Welfare Department (CWD) budget unit.

## II. CLARIFYING ALLOWABLE SPACE POLICY

***a. Less-than-arms-length:***

The FPB has received a number of questions regarding ownership and what constitutes a less-than-arms-length relationship. Counties have posed varying scenarios to the SCO and the CDSS. These scenarios include different entities that are being created at the local level. These entities then purchase or construct a building, and lease or rent the facility to the CWD. In these scenarios, the CWD proposes to claim the entire amount of the monthly facility cost for reimbursement instead of receiving a two percent use allowance or depreciation on the cost of the building.

According to federal Region IX, any building obtained under these conditions is considered a county-owned facility. An entity created by the county with the CWD leasing or renting the facility purchased by the created entity is permissible, though the CWD must claim the space cost using a two percent use allowance or depreciation, since this is considered a less-than-arms-length transaction.

Less-than-arms length is defined as a lease under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to:

(1) Divisions of an organization;
(2) Organizations under common control through common officers, directors, members;

(3) An organization and a director, trustee, officer, or key employee of the organization, or his/her family, directly or through corporations, trusts or similar arrangements in which they hold a controlling interest;
(4) Parties of the same governmental unit; or
(5) The governmental unit creates an authority or similar entity to acquire and lease the facilities to the governmental unit and other parties.

Questions regarding less-than-arms-length relationships should be directed to the SCO to determine whether the facility would be considered county-owned. CDSS would be contacted if the facility cost is determined to be an operating or rental cost.

***b. Interest and other Financing Costs:***

Interest is unallowable when a government borrows from itself or from a nonbona fide third parties. The financing costs associated with the otherwise allowable costs of building acquisition, construction, or fabrication, reconstruction or remodeling completed on or after October 1, 1980 are allowable, subject to the conditions, provided in OMB Circular A-87, Section B, 26b (1)-(4).

Questions regarding interest and financing costs should be directed to the CDSS when the financing is related to a rented or leased facility. The SCO should be contacted when the inquiry is related to a county owned facility.

***c. Land Purchases:***

The cost of land, and all costs associated with its acquisition are unallowable for reimbursement under the cost principles. These costs include: the purchase price, appraisal and negotiation fees, title search fees, survey fees, costs of consents, condemnation fees, clearing land use, demolishing or removing structures, and filling costs. However, interest is allowed only for the acquisition of land that is debt financed.

Questions regarding the purchase of land would be directed to the SCO or CDSS. Determination on who to call would depend on the nature of the inquiry, the purpose for the purchase of the land and how the county intends to claim the allowable cost.

***d. Alterations:***

Changes in the physical structure or arrangement of a facility, which does not constitute a betterment or addition is considered an alteration cost. Alteration costs on county-owned or rented facilities are allowable for reimbursement in the year of expenditure up to $25,000 per facility, provided these alterations are not included as part of the rental cost system or lease/rental agreement. The cost of an alteration project, which exceeds $25,000 would be amortized over a three year period and claimed in three annual installments; the first installment is claimed in the quarter in which the alterations project is complete, the final cost has been determined and the payment is made. The second and third installment is claimed in the first quarter of each subsequent fiscal year.

## III. CLARIFYING CDSS & SCO ROLES

### CDSS FPB - Straight leases and Rental Costs

The CDSS FPB responds to inquiries regarding operating leases and rental costs. A true operating lease is one in which the county is not acquiring any equity or ownership in the building. Lease payments for an operating lease can be claimed for reimbursement provided they do not exceed comparable rental rates.

There are many different types of leasing arrangements, including: monthly rental, annual rental, annual lease, lease-with-option to purchase, material equity lease, lease purchase, sale-and-leaseback arrangement, and a less-than-arms-length lease.

If the lease agreement is a sale-and-leaseback arrangement, a less-than-arms-length lease, lease purchase, a material equity lease, or a lease-with-option-to-purchase that meets the criteria of a capital lease, the lease payment is not eligible for reimbursement as a rental or lease cost. Occupancy costs under these arrangements must be claimed as county-owned space, and recouped at the two percent use allowance or depreciation (see Section I). Any lease arrangements under these circumstances should be discussed with the SCO.

### SCO - County Owned Facilities

All county-owned space is handled by the SCO, County Cost Plans Section. County-owned buildings are included in the countywide cost allocation plans, which are reviewed by the SCO. The CWD space costs are a part of the CCAP when the reimbursement amount is based on a two percent use allowance for the period of occupancy or depreciation over the useful life period.

County-owned facilities include buildings, which are owned by the county, purchased or constructed by the county, acquired through a capital lease, or joint exercise of powers agreement, and/or through formation of a non-profit entity. If there is any question about county ownership or interest in the facility the SCO should be contacted. If necessary, the SCO will coordinate with the CDSS to determine whether the building is considered county-owned or truly a leased/rented facility.

If a county is going to build a facility and finance the associated costs, the Auditor-Controllers Office should be contacted. The Auditor-Controllers Office will coordinate with the SCO and will assist with the development of the rental cost system. The rental cost system was previously referred to as the rental rate system, which was the method used for computing claimable costs. This method no longer requires prior approval. If a rental cost system is used the county is required to maintain complete, comprehensive cost information on file to support the costs. The rental cost system is prepared by the Auditors-Controllers Office and submitted to the SCO.

**<u>Contracts and Financial Analysis Bureau (CFAB) - Allocations</u>**

Space costs can impact a county's Proposed County Administrative Budget (PCAB). The CFAB is responsible for reviewing the PCAB during the March budgeting period and preparing county allocation amounts. If counties have questions regarding the impact of space costs on allocation amounts, or how space costs affect the county's PCAB, please contact the CFAB at (916) 657-3806. As a reminder, claiming does not ensure additional funding. Any requests for increased funding are handled by CFAB, through the PCAB process.

## IV. CLAIMING

Space expenditures are considered a support operating cost on the CEC. Space costs can be claimed in one of three different ways: to generic, to the functional level, or directly to a specific program. Counties are reminded that space expenditures must be necessary, reasonable, and properly related to the efficient administration of welfare programs. Also, A-87 Cost Principles do apply, which require that like costs be treated in a consistent manner.

- **To <u>Generic</u>:**

  ***DFA 325.1 – County Expense Claim Expenditure Schedule***

  There are two types of space costs reported to Generic: Those costs that cannot be identified to a specific function or program and have a departmentwide benefit; and the CCAP space costs that are approved by the SCO. These Generic space costs are claimed on different lines on the DFA 325.1.

  Generic space costs, those that are not included in the CCAP, are reported in the Support Operating Cost pool, with the cost claimed on the Space line to Generic. Space costs claimed to Generic will be allocated based upon reported casework hours.

  The CCAP space costs are claimed in the Support Operating Cost pool on the Space-Countywide Cost Allocation Plan (CCAP) line to generic. All CCAP space costs are claimed as Generic and allocated to programs based upon reported casework hours.

- **To the <u>Function</u>:**

  ***DFA 325.1 – County Expense Claim Expenditure Schedule***

  To claim space costs to the function level the Support Operating Cost pool is used. The actual cost is claimed on the Space line to the appropriate function. In order to claim costs to the function level a DFA 327.9 – Direct Charge Methodology Detail, must be submitted in accordance with the guidelines in CFL No. 97/98-42. Space costs reported to the functional level should benefit only the programs within that function. Space costs claimed to the functional level are distributed based upon casework hours reported within that function.

- **<u>Direct</u> to Program:**

  ***DFA 325.1B – County Expense Claim Direct Cost Input Schedule***

  Direct to program space costs are claimed on the DFA 325.1B, using a six digit program identifier number (PIN) ending in “89” – Operating Cost Space (Non-CCAP). The benefiting program will determine which program code is used. In order to claim costs in this manner a county must have a DFA 327.9 on file. For information regarding direct charging and submittal of a DFA 327.9, please see CFL No’s. 97/98-42 and 97/98-26. Space costs claimed directly to a specific program should only benefit the program where costs are claimed.

If additional information is needed regarding the direct charging option available for claiming space costs, please reference the following CFL’s:

CFL No. 97/98-01, dated July 2, 1997 (9/97 Time Study Letter-CWD CAP Overview)
CFL No. 97/98-26, dated October 15, 1997 (9/97 Claim Letter)
CFL No. 97/98-42, dated January 21, 1998 (12/97 Claim Letter)
CFL No. 97/98-48, dated January 12, 1998 (CWD Training Questions and Answers)

## QUESTIONS AND ANSWERS

### ***CDSS FPB***

Following are examples of space related questions that counties should direct to the CDSS, FPB.

1. Question: Can a county claim the actual lease payments on a building for reimbursement?

   Answer: If the building lease is truly an operating lease in which the county is not acquiring any equity or ownership in the building, then the lease payments can be claimed for reimbursement provided they do not exceed comparable rental rates.

   If the lease agreement is a sale-and-leaseback arrangement, a less-than-arms-length lease, or a material equity lease, the lease payments are not eligible for reimbursement at this rate. Occupancy costs under these arrangements must be claimed as county-owned space, using a two percent use allowance or depreciation.

2. Question: Can a county claim the cost of a new building to their CalWORKs single allocation?

Answer: If the building is used only for CalWORKs–eligible clients to provide services, and the CWD is paying the entire lease costs, the space may be claimed to the county's CalWORKs allocation under direct charge claiming options.

3. Question: Can a county claim space costs to its CalWORKs allocation for CWD staff who are co-located with other local county department staff in order to provide one-stop services for CalWORKs clients?

Answer: To be allowable for federal reimbursement, costs must be allocated to programs in relation to the benefits received. Accordingly, space occupied by CWD and other local county department staff providing services to CalWORKs clients, consistent with their Welfare to Work Plan may claim space costs to their CalWORKs allocation. If in these one-stop centers other agency staff provide services beyond those allowable in the CalWORKs plan or to non-CalWORKs clients, the cost must be allocated accordingly. In order to claim the entire cost as a direct charge to CalWORKs, counties must submit a DFA 327.9 in accordance with CFL No. 97/98-48, dated January 12, 1998.

Counties should coordinate at the local level to ensure appropriate claiming of these space costs. Counties are responsible for ensuring that costs are equitable and claimed in a manner consistent with OMB A-87 guidelines.

4. Question: A county is considering renting a building, which is owned by a non-profit corporation created by the County. The CWD wants to sign a lease to rent the building. Can the CWD claim 100 percent of the rental cost for the building?

Answer: Under this scenario the building could not be rented and reimbursed at 100 percent. The county is creating the non-profit corporation. Thus, a less-than-arms-length relationship would exist. The building would be considered a county-owned facility and reimbursed at an annual two percent use allowance.

5. Question: A county intends to co-locate the County Human Services Department and the District Attorney's Family Support Division into a single leased facility. Would the lease cost be considered an operating lease, with the lease cost and related costs claimed on the CEC and the Child Support Claim?

Answer: Yes, the single leased facility would be considered an operating lease. The cost must be allocated appropriately between the two claiming mechanisms. Costs for space occupied under a straight lease are allowable to the extent that they are reasonable in relation to the rental costs of comparable space in privately-owned buildings in the same locality.

Operating lease costs can be claimed as direct costs when paid from the grantee budget unit. If paid from central appropriation, the cost must be included in the CCAP.

6. Question: What are the provisions if a county wants to enter into a ten-year lease with the option to renew for two additional ten-year terms and to lease improvements on the property through a non-profit consortia?

Answer: If a county executes the proposed ten-year lease, the lease would be considered a capital lease and the building would be treated as though it had been purchased on the date the lease agreement was executed. The costs of the improvements carried out on the building should be added to the capitalized costs of the building and the entire amount recovered at two percent per year. If the county finances these planned improvements, the financing would have to be obtained from a bona fide third party in order to recover the financing costs over the life of the debt. This would preclude the county from borrowing from itself.

7. Question: When is interest allowable?

Answer: Certain portions of the financing costs are eligible for reimbursement. The county should determine if they meet the requirements in OMB A-87, Attachment B, Section 26 before claiming any interest costs.

Interest on borrowed capital or the use of a governmental unit's own funds, are unallowable no matter how they are represented.

8. Question: Is interest claimable on borrowings for alterations?

Answer: According to OMB A-87, interest on borrowings for reconstruction or remodeling completed after October 1, 1980 is allowable. Reference CFL 95/96-27, dated March 26, 1996.

***SCO County Cost Plans***

Following are examples of space related questions that counties should direct to the SCO, County Cost Plans Unit.

1. Question: A county is in the process of building a new office and would like to receive a higher reimbursement rate than the annual two percent. Can the method of accelerated payment be used to receive a higher return rate? If not, are there any other alternatives?

Answer: In the past, an alternative to claiming space costs through a use allowance or depreciation was the Capital Expenditure Method. This method required a great amount of time and resources to review and approve. According to Cost Plan Information Release No. 11-91, effective November 27, 1991, the Capital Expenditures Method is no longer an alternative.

For grant reimbursement purposes, the county can take a two percent use allowance on the actual cost of the new building, as well as, interest expense incurred or paid over the life of the incurred debt for the building and associated land. The interest payable over the life of the financing agreement must be supported by an interest amortization schedule.

2. Question: A county welfare department is interested in procuring a new building. Can a non-profit organization be established to obtain financing for the construction or purchase of the building?

Answer: While an organization such as this might be structured in such a manner as to be separate from a county's governmental functions, there would still be a lack of true independence and a less-than-arms-length relationship.

A building purchased in this manner would become a county building. An annual two percent use allowance could be computed on the total acquisition cost of the building (but not on associated land). This use allowance as well as interest expense incurred or paid over the life of the incurred debt for the building and any associated land which is occupied by the county department could be included in the county cost plan or claimed directly to CDSS.

3. Question: How would the cost be claimed if our department elects to lease a building from a quasi-public agency in a less-than-arms-length relationship?

Answer: The recovery of such costs, fall under the provisions of OMB A-87, Attachment B, Section 38. Rental or lease costs under less-than-arms-length leases are allowable only up to the amount that would have been allowed had title to the property vested in the county. The costs that are recoverable in this situation are the same as if the county-owned the building.

4. Question: If a county elects to lease a building which is owned entirely by a private entity that has no relationship to the county how would these costs be recovered?

Answer: The recovery of these costs will fall under the provisions of OMB A-87, Attachment B, Section 38, a or d. Rental rates allowed under section a. (operating lease) must be reasonable and in proportion to rental costs of comparable properties in the area. Rental rates allowed under section d. (capital lease) are required to be treated as capital leases under GAAP and are recoverable only to the amount that would be allowed had the property been purchased by the county.

5. Question: Can a county depreciate its buildings?

Answer: Yes, but the Federal government requires a singular reimbursement treatment for all assets in a single class. Since general-purpose office structures are viewed as a single class of assets, they all must be claimed either through depreciation or use allowance. A combination of the two methods may not be used within a single class of assets.

6. Question: Can a non-profit corporation set up by the County lease-purchase a building from the non-profit corporation and claim 100 percent of the interest costs and two percent of the acquisition costs?

   Answer: This type of arrangement would not be considered a lease-purchase agreement. The building is already owned by the County and only a two percent use allowance could be claimed and some financing costs if the requirements are met as outlined in OMB A-87, Attachment B, Section 26.

Due to the complexity of questions involving space claiming requirements and allowability, we are requesting that any future inquiries where alternatives are being proposed or considered be submitted in writing to the appropriate agency. Questions that are straightforward or of general nature will continue to be answered verbally. To assist you, a space approval requirements chart and a phone list is attached for your reference. You may also contact the county cost plan coordinator located in the County Auditor-Controllers Office.

We hope the information provided is useful. If you have any questions, or would like to discuss the contents of this letter, please contact the CDSS FPB at (916) 657-3440 or Mr. Tom Cotton, of the SCO County Cost Plans Section at (916) 322-8399.

***Original Document Signed By***
***George E. Peacher, Jr. on 10/13/98***

GEORGE E. PEACHER, JR., Chief
Fiscal Systems and Accounting Branch
California Department of Social Services

***Original Document Signed By***
***Mike J. Havey on 10/13/98***

MIKE J. HAVEY, Section Supervisor
County Cost Plans Section
Division of Accounting
State Controller's Office

c: CWDA

## SPACE CONTACT / APPROVAL REQUIREMENTS

| | **SCO Contact** *prior to claiming* | **SCO Approval** *in CCAP* | **COSS Contact** *prior to claiming* | **No Contact/ Approval** *Required* |
|---|---|---|---|---|
| 1) Lease Payments of a lease purchase or lease option which county interprets as an operating lease | **X** | | | |
| 2) Use allowance/depreciation on excess or unoccupied space * | **X** | | | |
| 3) County-owned space claimed through use allowance or depreciation | | **X** | | |
| 4) Operating Lease | | | | **X** |
| 5) *Renovations:* | | | | |
| County-owned space, claimed by use allowance or depreciation | | **X** | | |
| County-leased space ** | | | | |
| 6) Alterations and Maintenance | | | | **X** |
| 7) Lease cost for excess or unoccupied space | | | **X** | |

*Note: Contact/Approval does not consitute additional funding - see CFAB*

** Approval required from DHHS, DCA*

*** Cost allocated over the life of the lease cannot exceed comparables.*

*10/98*

# CDSS - FPB
# COUNTY ASSIGNMENTS

| COUNTY | POLICY ANALYST | PHONE NUMNBER | COUNTY | POLICY ANALYST | PHONE NUMBER |
|---|---|---|---|---|---|
| 1 Alameda | Nora DuFur | 916-654-0962 | 31 Orange | MaryAnn Warren | 916-654-9926 |
| 2 Alpine | Lili Leng | 916-657-3428 | 32 Placer | Lili Leng | 916-657-3428 |
| 3 Amador | Lori Starnes | 916-654-0937 | 33 Plumas | Teri Vienna | 916-657-3752 |
| 4 Butte | Donna Richardson | 916-654-0958 | 34 Riverside | Dale Vierling | 916-654-2695 |
| 5 Calaveras | Johnny Agwumezie | 916-654-0953 | 35 Sacto-DPS | Jeanne Wexler | 916-654-0940 |
| 6 Colusa | Janice Yee | 916-654-0964 | 36 Sacto-Ch/Ad | Jeanne Wexler | 916-654-0940 |
| 7 Contra Costa | Cindi Carleton | 916-654-0690 | 37 San Benito | Bunny Furlo | 916-657-1645 |
| 8 Del Norte | MaryAnn Warren | 916-654-9926 | 38 S. Bernardino | Lori Starnes | 916-654-0937 |
| 9 El Dorado | Jeanne Wexler | 916-654-0940 | 39 San Diego | Nora DuFur | 916-654-0962 |
| 10 Fresno | Bunny Furlo | 916-657-1645 | 40 S. Francisco | Lili Leng | 916-657-3428 |
| 11 Glenn | MaryAnn Warren | 916-654-9926 | 41 San Joaquin | Cindi Carleton | 916-654-0690 |
| 12 Humboldt | Jeanne Wexler | 916-654-0940 | 42 S. Luis Obispo | Teri Vienna | 916-657-3752 |
| 13 Imperial | Janice Yee | 916-654-0964 | 43 San Mateo | Karen Hobson | 916-654-0949 |
| 14 Inyo | Janice Yee | 916-654-0964 | 44 Santa Barbara | MaryAnn Warren | 916-654-9926 |
| 15 Kern | Johnny Agwumezie | 916-654-0953 | 45 Santa Clara | Cindi Carleton | 916-654-0690 |
| 16 Kings | Karen Hobson | 916-654-0949 | 46 Santa Cruz | Cindi Carleton | 916-654-0690 |
| 17 Lake | Lori Starnes | 916-654-0937 | 47 Shasta | Lori Starnes | 916-654-0937 |
| 18 Lassen | Johnny Agwumezie | 916-654-0953 | 48 Sierra | MaryAnn Warren | 916-654-9926 |
| 19 LA-DCFS | Donna Richardson | 916-654-0958 | 49 Siskiyou | Dale Vierling | 916-654-2695 |
| 20 LA-DPSS | Janice Yee | 916-654-0964 | 50 Solano | Nora DuFur | 916-654-0962 |
| 21 Madera | Nora DuFur | 916-654-0962 | 51 Sonoma | Cindi Carleton | 916-654-0690 |
| 22 Marin | Donna Richardson | 916-654-0958 | 52 Stanislaus | Lori Starnes | 916-654-0937 |
| 23 Mariposa | Bunny Furlo | 916-657-1645 | 53 Sutter | Bunny Furlo | 916-657-1645 |
| 24 Mendocino | Donna Richardson | 916-654-0958 | 54 Tehama | Teri Vienna | 916-657-3752 |
| 25 Merced | Johnny Agwumezie | 916-654-0953 | 55 Trinity | Jeanne Wexler | 916-654-0940 |
| 26 Modoc | Lili Leng | 916-657-3428 | 56 Tulare | Teri Vienna | 916-657-3752 |
| 27 Mono | Dale Vierling | 916-654-2695 | 57 Tuolumne | Karen Hobson | 916-654-0949 |
| 28 Monterey | Lili Leng | 916-657-3428 | 58 Ventura | Nora DuFur | 916-654-0962 |
| 29 Napa | Johnny Agwumezie | 916-654-0953 | 59 Yolo | Bunny Furlo | 916-657-1645 |
| 30 Nevada | Karen Hobson | 916-654-0949 | 60 Yuba | Teri Vienna | 916-657-3752 |

Note: There are 60 counties listed (instead of 58) because LA and Sacramento have two agencies: (LA-DCFS, LA-DPSS, and Sacto-DPS, Sacto-Child/Adult).

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