MEMORANDUM FOR: EMILY STOVER DeROCCO
Assistant Secretary for
Employment and Training

FROM: JOHN J. GETEK
Assistant Inspector General
for Audit

SUBJECT: State of Texas
Employment Security Program
Real Property Issues Related to Federal Equity Properties
Management Letter Report No. 06-01-003-03-325

Some State Employment Security Agency (SESA) local offices in which the Department of Labor (DOL) has Federal equity are no longer being used 100 percent for the states' employment security program -- unemployment insurance (UI) and employment service (ES). Some "one-stop centers" mandated by the Workforce Investment Act (WIA) are beginning to collocate with UI/ES offices in existing SESA local offices, thereby reducing the UI and ES programs' occupancy in these buildings to less than 100 percent. Also, the increasing use of UI telephone claim centers has further reduced, or eliminated, UI program space in some local offices. Because of the DOL equity in some SESA local offices, the Office of Inspector General (OIG) has performed a limited review of SESA real property issues in Texas

In our opinion, these issues will probably have nationwide impact. Consequently, some national policy should be established to address these issues.

BACKGROUND

The Secretary of Labor awards grants to the 50 states, the District of Columbia, the Virgin Islands, and Puerto Rico to administer their employment security programs. Since the early days of the employment security programs, the purchase of real properties for use in administering the programs has been an allowable use of Federal funds. Nearly all states have purchased property with SESA grant funds or Reed Act funds (Title IX of the Social Security Act). While title to these properties is vested in the respective states, the Federal Government has acquired equity in the properties to the extent that grant funds (Title III UI and/or Wagner-Peyser) were used over

an extended period of time to acquire real property. In general, DOL's role in SESA real property administration is limited to providing policy guidance, assuring compliance with applicable requirements, and approving the use of grant funds for capital expenditures to include the recapture of equity. SESAs are responsible for the acquisition, use, and disposition of real property acquired with grant and Reed Act funds.

On September 30, 1997, the OIG issued audit report number 06-97-056-03-325, "U.S. Department of Labor Equity in SESA Real Property." This report indicated that as of September 30, 1996, 47 of the 53 SESAs had $380 million in Federal equity (at cost basis) in 458 properties. Also, 21 SESAs were continuing to amortize up to another $61 million on 132 of these 458 properties.

Since our September 30, 1997, report, some states have disposed of, or are planning to dispose of, Federal equity properties because the ever-increasing UI telephone claim centers have reduced the need for UI program space. Furthermore, the WIA allows one-stop centers to use UI/ES Federal equity property for WIA purposes as long as the UI or ES program has a presence in the property, further reducing UI/ES space in federally-funded properties. When the WIA program's one-stop centers occupy space in these properties, the one-stops must pay their fair share of the costs. (WIA, Section 193)

THE ISSUES AND RECOMMENDATIONS

Issue 1: *Do shared facility agreements between the Texas Workforce Commission (TWC) and the local Workforce Investment Boards (Board) for one-stop centers require the one-stop to pay more than operations and maintenance (O&M) costs when the properties' costs have not been fully amortized?*

The shared facility agreement between TWC and each Board is not appropriate, since the agreement requires the one-stop to pay only O&M costs based on the one-stop's percentage of total occupancy of the facility even if the UI/ES programs are still amortizing the property's cost against UI/ES grants. The agreement does not require the one-stop to pay its share of the amortization; TWC is paying the total cost of amortization. Thus, the one-stops are occupying space in the facilities rent-free, and the UI/ES programs are paying for space costs not allocable to their programs in violation of WIA, Section 193, which provides:

> *(a) In General.--Notwithstanding any other provision of law, the Governor may authorize a public agency to make available, for the use of a one-stop service delivery system within the State which is carried out by a consortium of entities that includes the public agency, real property in which, as of the date of the enactment of the Workforce Investment Act of 1998, the Federal Government has acquired equity through the use of funds provided under title III of the Social Security Act (42 U.S.C. 501* et seq.*), section 903(c) of such Act (42 U.S.C.*

> *1103(c)), or the Wagner-Peyser Act (29 U.S.C. 49 et seq.).*
>
> *(b) Use of Funds.--Subsequent to the commencement of the use of the property described in subsection (a) for the functions of a one-stop service delivery system,* ***funds provided under the provisions of law described in subsection (a) may only be used to acquire further equity in such property, or to pay operating and maintenance expenses relating to such property in proportion to the extent of the use of such property attributable to the activities authorized under such provisions of law****.* [Emphasis added.]

In addition to the above criteria, Federal cost principles state that costs are allocable and chargeable to a particular cost objective only in accordance with the relative benefits received. (See OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments," Attachment A, paragraph C.3.a., and OMB Circular A-122, "Cost Principles for Non-Profit Organizations," Attachment A, Paragraph A.4.a.)

We did not perform an audit of amortization costs or O&M costs incurred by the UI/ES programs or one-stops for the eight properties in question. We computed property amortization costs charged to the UI/ES grants that were not applicable to the UI/ES programs based on information (monthly amortization amounts, dates the one-stops moved into the property, and the percentage of staff in each property -- UI/ES and Board) that TWC staff provided to us. The following table identifies the "rent costs" the UI/ES grants incurred on behalf of other programs.

TWC Incurred $1,080,417 UI/ES Grant Costs for Nonapplicable UI/ES Rent as of 6/30/01

Location	Monthly Amortization	TWC Occ.	Board Occ.	Move In Date	Board Share	Months Occ.	Non-UI/ES Rent
McKinney	$ 2,576	.64	.36	1/1/98	$ 927	42	$ 38,934
Waxahachie	5,629	.33	.67	9/1/97	3,772	46	173,512
Marshall	5,907	.09	.91	10/1/98	5,375	33	177,375
Brownsville	10,425	.16	.84	5/1/99	8,757	26	227,682
Temple	6,419	.53	.47	12/1/97	3,017	43	129,731
Sherman	4,689	.2963	.7037	10/1/97	3,300	45	148,500
Bay City	5,562	.42	.60	4/1/98	3,337	39	130,143
Bryan	2,590	.22	.78	4/1/99	2,020	27	54,540
Totals	**$43,797**		**0.6965**		**$30,505**		**$1,080,417**

Because the employment security program still has a presence in these properties and the DOL has continued to accumulate equity in these properties, we do not question these costs assuming that the TWC immediately revises the shared facility agreements for these properties to ensure that the other occupants pay their fair share of total space costs in accordance with WIA, Section 193,

effective July 1, 2001.

This issue goes beyond the State of Texas.

The WIA program year ends on June 30, 2001. Consequently, states and WIA one-stops occupying UI/ES offices will be renegotiating cost-sharing agreements for the new program year. It is imperative that these cost-sharing agreements ensure that the UI, ES, and WIA programs pay only their fair share of space costs in accordance with WIA, Section 193.

Recommendations: The OIG recommends that the Assistant Secretary for Employment and Training instruct the TWC to **immediately** revise the shared facility agreements, effective July 1, 2001, for properties that are still being amortized. TWC should charge the one-stops their pro rata share for office space amortization plus O&M costs. Since the TWC is the lessee, TWC should continue to charge the full monthly amortization to the UI/ES program, accrue the full equity, and use the other programs' share of the amortization as rental income to offset UI/ES space costs.

We also recommend the Assistant Secretary for Employment and Training immediately issue national policy to address this issue, otherwise, the UI and ES programs will incur unallowable costs.

Issue 2: *Do shared facility agreements between TWC and the Board require the one-stop to pay more than O&M costs when the property is a lease/purchase property, with TWC as the lessee obtaining title and DOL accruing equity rights when the lease is paid off?*

The shared facility agreement between TWC and each Board occupying some space in TWC's lease-purchase property is appropriate since the agreement requires the one-stop to pay its pro rata share of full space costs (lease amount plus O&M costs) based on the one-stop's percentage of total occupancy of the facility. The one-stop's allocated costs are calculated based on the ratio of one-stop's occupants to total facility occupants.

TWC is the sole responsible party, or lessee, of the lease/purchase properties. Each one-stop is a sublessee of TWC. These shared facility agreements on the lease-purchase properties allow TWC to remain the potential sole owner of the properties, with full DOL equity, when the lease/purchases are finalized, and also help to reduce TWC's space cost. The following schedule shows the unamortized balance of the lease/purchase agreements as of May 31, 2001.

Address	Balance at 05/31/01
Austin - 12312 N. Mopac	$745,100
Houston - 8990 Lakes @ 610	664,883
Houston - 10125 Emnora Ln	467,983
Dallas - 4234 Polk St.	439,916
Bedford Mid Cities - 1809 Forest Ridge	447,500
Irving - 2925 Skyway Circle	560,333

Recommendation: We recommend the Assistant Secretary for Employment and Training instruct the TWC to continue with this arrangement, and when the leases are paid off document DOL equity in the properties.

Because other states also have lease/purchase properties, we also recommend the Assistant Secretary for Employment and Training immediately issue national policy to also address this issue to protect the potential Federal equity in lease/purchase properties.

Issue 3: *Can a local Board, not the one-stop Center, occupy rent-free space in an UI/ES amortized property when TWC staff occupies only 2 percent of the property?*

Currently, the local Workforce Investment Board is occupying rent-free approximately 98 percent of the space (41 of 42 staff) in a fully amortized UI/ES office at 245 E. Levee Street, Brownsville, TX. The Board is paying its pro rata share of O&M costs.

The WIA, Section 193(a), provides:

> *In General.--Notwithstanding any other provision of law, the Governor may authorize a public agency to make available,* ***for the use of a one-stop service delivery system*** *within the State which is carried out by a consortium of entities that includes the public agency, real property in which, as of the date of the enactment of the Workforce Investment Act of 1998, the Federal Government has acquired equity through the use of funds provided under title III of the Social Security Act (42 U.S.C. 501 et seq.), section 903(c) of such Act (42 U.S.C. 1103(c)), or the Wagner-Peyser Act (29 U.S.C. 49 et seq.).* [Emphasis added.]

While the Board does not meet the strict definition of "for the use of a one-stop delivery system," the Board is essential to the one-stop delivery system.

Allowing the Board to occupy this space is economical to the program in that it allows WIA funds to be more effectively used to serve clients. TWC cannot justify maintaining this property to accommodate the one TWC staff needed at this location; therefore, TWC would have to move the TWC staff to leased space incurring additional administrative rent costs using funds that

could be better used providing employment security services to the public. Furthermore, the Board would have to acquire significant leased space (for 41 staff) resulting in additional administrative costs dollars that could be better used to serve WIA clients.

In our opinion, the Employment and Training Administration (ETA) should attempt to apply a broad definition to WIA, Section 193, to allow the use of such properties for any use in support of the one-stop delivery system, as long as ES or UI has a presence in the property to allow the WIA system to take efficient advantage of properties already paid for with DOL funds.

Recommendation: We recommend the Assistant Secretary for Employment and Training request a legal opinion as to whether WIA, Section 193, is broad enough to include any use in support of the one-stop delivery system or is it only to be applied to the "use as a one-stop delivery center."

Issue 4: *What is TWC planning to do with proceeds from sold agency-owned (Federal equity) properties and the pending sale of other agency-owned (Federal equity) properties?*

TWC recently sold two properties, paid off one property in full that was being amortized, and placed the remaining proceeds of approximately $544,805 in an interest-bearing escrow account. TWC has 15 more properties the agency is preparing to sell and desires to use the proceeds to either fully pay off some properties that are currently being amortized and/or pay off the leases on lease/purchase properties, which are more valuable properties than those being amortized. The lease/purchase agreements allow the State to purchase the buildings at any time. It would be an advantage to TWC and DOL to use the proceeds to fully pay off these properties.

The State already has some cash and will soon have additional cash that could be used to pay off these properties. As stated above, the State currently has $544,805 of sales proceeds in an interest bearing escrow account. The State has an additional nine properties for sale that have already been appraised with total minimum asking bids of approximately $2.2 million. Furthermore, the State has six additional properties in the sales approval process that have cash Federal equity (at acquisition cost) of approximately $1.5 million. Consequently, these potential sales proceeds of approximately $4 million could pay off several properties currently being amortized or leased (to purchase). This process would free up UI/ES grant funds currently being used to pay rent to provide services to clients.

The other option is to return the proceeds to the U.S. Treasury as miscellaneous receipts and deny the State's employment security program the benefit of these funds.

Currently, ETA's position is that the proceeds from the sale of these 17 properties can be used to pay off properties or lease/purchase agreements as long as the proceeds are used to pay off properties/leases only to the extent that UI and/or ES staff occupy the building.

For example, assume the State sold a fully amortized UI/ES property for $1 million. The property was initially amortized against Title III UI grants (60 percent) and Wagner-Peyser grants (40 percent). Assume also that the State has another property that has a $1 million unamortized balance (or a $1 million lease/purchase payoff to own the property) that the State wants to use the proceeds to pay off the amortization or lease. However, this property now houses only ES personnel.

According to current ETA instructions, the State could not use the proceeds to pay off the property since ES grants only funded 40 percent of the property's acquisition cost; i.e., the ES portion of the sales proceeds was only $400,000. However, if the State had another ES building with a $400,000 unamortized balance (or a $400,000 lease/purchase payoff to own the property), the State could use the 40 percent ES portion of the $1 million sales proceeds to pay off that property.

Because of the advent of the UI telephone call centers, the number of UI staff in local offices is diminishing. Consequently, local offices with both UI and ES equity are being sold. The properties the States want to pay off are now predominantly ES offices. Therein lies the problem. The UI program funded the majority of the costs of the buildings being sold, yet the offices to be paid off are predominantly ES.

The Office of Inspector General presents the following argument as to why the sales proceeds from UI/ES funded properties should be allowed to pay off employment security program properties regardless of whether the properties to be paid off house ES, UI, or both programs.

When the property being sold was initially funded, ES and UI grants were properly charged their fair share of the property's acquisition costs based on each program's proportionate share of the space; i.e., funds appropriated by Congress were spent in accordance with their authorized purpose. When the property was sold, the sales proceeds did not represent a credit against past years' expenditures for UI/ES space. The sales proceeds represent cash available for reinvestment in other employment security program properties, if necessary.

The Common Rule, 29 CFR, Part 97.32(c)(1) provides:

> *. . . in those situations where a grantee . . . 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.*

While each component of the State's employment security program – UI (Title III) and ES (Wagner-Peyser) – is funded separately, the funds source for each program's appropriation is Federal Unemployment Tax Act (FUTA) taxes. Consequently, in the OIG's opinion, to ensure that the proceeds from the sale of Federal equity properties continue to benefit the employment

security program, the widest possible definition of “program” should be applied in complying with 29 CFR 97.32(c)(1) cited above.

Recommendation: We recommend the Assistant Secretary for Employment and Training request a legal opinion as to whether “same program” in 29 CFR 97.32(c)(1) is broad enough to allow the states to reinvest Federal equity real property sales proceeds in any employment security property regardless of the properties’ original funding source (ES or UI).

The issues discussed in this management letter have been discussed with TWC officials. These officials are in agreement with our recommendations.

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This management letter was issued to your office in draft on June 21, 2001, requesting a response by July 16, 2001. As of September 28, 2001, we have not received a response. We are therefore issuing this final management letter and submitting it for your resolution action. We request a response within 60 days.

It is your office’s responsibility to promptly transmit the attached report to program officials for resolution.

If you have any questions regarding this management letter report, please contact Mr. John Riggs, Regional Inspector General for Audit, Dallas, at (214) 767-6980.