

STATE CONTROLLER POLICY

Improvements on Owned or Leasehold Property with Federal Funds

1) **Applicability**

This policy applies to State agencies.

2) **Classification of Improvements**

Under the Uniform Guidance, improvements are classified as either rearrangement and reconversion costs or as capital expenditures.

3) **Rearrangement and Reconversion Costs**

2 CFR 200.462 Rearrangement and reconversion costs provides that costs incurred for ordinary and normal rearrangement and alternation of facilities are indirect costs. Special arrangements and alterations costs incurred specifically for a Federal award are allowable as a direct cost with the prior approval of the Federal Awarding agency or pass-through entity.

a. Requirements

1. The costs are incurred specifically for a Federal award, and
2. The grant award requires alterations to the subrecipient's facility such that award cannot be implemented without such modifications or alterations, and
3. The Federal agency or pass through entity (State agency) has provided prior approval for these costs, and
4. The modifications are minimal, and do not significantly change or alter the existing facility, and
5. The alterations follow all Cost Principles, such as reasonable, and necessary to the project being funded, and
6. The cost is \$50,000 or less. This amount is based on the capitalization threshold for leasehold improvements in the Fiscal Procedures Manual Chapter 4 Section 2.4.1.

Some examples of modifications are:

- a. Adding a divider to create an additional office space

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- b. Enhancing the sound-proof so that privacy may be maintained
- c. Cosmetic modifications

If an improvement is for ordinary and normal rearrangement and alteration of facilities the cost is under \$50,000, and modifications do not meet the other requirements for a direct cost, then the costs are allowable as indirect costs.

If the facility or property requiring alteration is leased, the State agency should verify with the property owner that the lease allows such alterations, as well as options available to lessee. Often, minor alterations may be provided (usually at a lower cost) by the owner, with those costs prorated across the life of the lease. This easily allows the indirect costs to be accounted for in the subrecipient's indirect costs associated with the award. If that is not an option, at a minimum, the property owner's approval for such alterations must be obtained. Additionally, the State agency (lessee) should obtain clarity regarding the requirement for restoring the space to the same condition immediately prior to the alterations.

Rearrangements do not create a fiscal asset, therefore are not considered to be a Capital Expenditure.

4) Capital Expenditures

a. Requirements

Improvements on Owned or Leasehold property are capitalized when all the following criteria are met:

1. Enhance the value or useful economic life of the leased asset
2. Are more than just maintenance or repairs
3. Are expected to be used for more than one year
4. Cost over \$50,000

When utilizing SLFRF funds for capital expenditures, it is important to first consider 2 CFR 200 Subpart E, Cost Principles prior to approving those expenditures. A full cost analysis should be undertaken. Consider if the improvements are allowable and allocable within the SLFRF Expenditure Category. Cost reasonableness should be evaluated and justified with a clear rationale for utilizing federal funds for the specific project, especially if the improvements will be for a leasehold property.

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There are two different approaches for capital expenditures depending on the funding source.

1. SLFRF Revenue Loss Funded Capital Expenditures

The Treasury SLFRF Interim Final Rule FAQs 13.14 and 13.15 provide that the property standards in the Uniform Guidance (2 CFR 200.310-200.316) do not apply to property, supplies, or equipment acquired using revenue loss funds.

2. All other SLFRF Funded Expenditures and Federal Funded Expenditures

a. 2 CFR 200.311-316 apply for all non-Revenue loss capital expenditures.

These provisions include the requirements for the use of federal funds for capital expenditures, including property, equipment, and supplies.

b. 2 CFR 200.311 provides that the title of the real property acquired or improved under the Federal award will vest upon acquisition in the recipient or subrecipient. The property owner has ownership of the capital expenditure and must carry adequate insurance and agree to maintain the property for the use intended by the federal funds. When real property is no longer needed for the originally authorized purpose, the recipient or subrecipient must obtain disposition instructions from the Federal agency or pass-through entity. The instructions must specify one of the following disposition methods:

1. Retain the title and reimburse the federal entity in an amount equal to the percentage of cost of the property or improvement based upon fair market value;
2. Sell the property and reimburse the federal entity in the amount of the percentage of the federal interest in the property; or
3. Transfer title of the property to the federal entity or third party approved by the federal entity.

c. 2 CFR 200.312 applies only to federally owned property, generally surplus property.

d. 2 CFR 200.313 pertains to equipment purchased with federal funds with a value of over \$5,000 per unit that will increase to \$10,000 for awards made on or after 10/1/2024.

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- e. 2 CFR 200.314 provides the requirements for excess supplies over \$5,000 that will increase to \$10,000 for awards on or after 10/1/2024.
- f. 2 CFR 200.315 details the use of intangible property and the rights therein.
- g. 2 CFR 200.316 provides that the Federal agency or pass-through entity may require the recipient or subrecipient to record liens or other appropriate notices of record to indicate that personal or real property has been acquired or improved with a Federal award and that use and disposition conditions apply to the property.
- h. Real property, equipment, and supplies with a current fair market value of \$5,000 or less (per unit) may be retained, sold, or otherwise disposed of with no further responsibility to the Federal agency or pass-through entity. The threshold will increase to \$10,000 on or after 10/1/2024.

5) Federal Interest in the Property for SLFRF non-revenue loss funds

For SLFRF, as noted in 2 CFR 200.316, when the Federal Government provides funding for a substantial improvement in property, such as for a capital expenditure, the recipient/subrecipient is required to hold the property in trust for beneficiaries of the project or program under which the property was acquired or improved. The Federal awarding agency may require a lien to the property called a Notice of Federal Interest (NFI). A recipient/subrecipient may also use covenants or similar agreements as long as these agreements create a Federal interest in the property.

1. The recipient/subrecipient must notify and obtain agreement from the owner of the property of the Federal interest in the property.
2. The owner of the property is required to file a Notice of Federal Interest (lien) on the property. This is a legal document that must be filed within the county jurisdiction where the property is located to protect the financial and public interests in the property. The NFI must reference the Federal Award Number (for SLFRF it is SLFRP0126), a complete description of the project, a legal description of the property,

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and contain the property owner's signature and it must be notarized. A copy of the NFI should be provided to the state agency and maintained in the master file of record. (See attached example)

3. This interest includes maintaining the property for the same (or like) purposes as the funding intended, and following all federal requirements for the useful life of the property.
4. Per 2 CFR 200.330, the Federal agency or pass-through entity must require the recipient or subrecipient to submit reports on the status of real property in which the Federal Government retains an interest. For SLFRF and other instances where the Federal Government's interest in the real property extends, for 15 years or more, the Federal agency or pass-through entity may require the recipient or subrecipient to report at various multi-year frequencies.

6) Justification for Capital Expenditures for SLFRF non-revenue loss funds

Justification for the capital expenditure is required for SLFRF funds and should include the following:

1. Description of harm or need to be addressed and why the harm was exacerbated by the COVID-19 pandemic.
2. Explanation of why a capital expenditure is appropriate to address the harm or need over the useful life of the capital asset.
3. Comparison of the capital expenditure against at least two alternative capital expenditures that demonstrates why the proposed capital expenditure is superior. If relevant, compare the proposal against improving existing capital assets or for leasing other capital assets. Quantitative data should be used when possible or an explanation for lack of data, including the
 - a. Effectiveness of addressing harm
 - b. Comparison of total cost

The following should be considered and addressed in the justification:

1. As with all capital expenditures, a major factor should be if the proposed expenditure is the best, most viable option in terms of other solutions available.

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2. In terms of cost reasonableness, will the capital expenditure increase the value of the property such that it would warrant the expenditure?
3. Is the property owner aware of and in agreement with the federal interest in the property and willing to abide by the terms and conditions set forth in Treasury's Guidance?
4. Have other options been considered, and documented? And among those options, how was this option determined to be the best approach?

7) Award and Post Award Requirements

Additional terms and conditions should be spelled out initially in the RFA or RFP, as well as in the grant agreement or contract that clearly detail the specifics related to authority/agreement to federal requirements. This includes establishing federal interest in the property, not selling, transferring, assigning or conveying any interest in the property without conveying a covenant of purpose, use and ownership, maintaining the same or like purpose for the property, and all disposition requirements as set forth by Treasury. To ensure appropriate language and requirements are included in grant agreements or contracts, departments should work with their Central Contracts Unit representative. Monitoring will need to occur to verify that the property continues to be used for the same or like purpose. If the purpose of the involved property changes to a use outside of the given parameters, or if the property is sold, disposition requirements apply. The percentage of Federal Interest in the property would need to be calculated and that percentage would be applied to the proceeds from the sale to calculate the amount to pay the Federal Interest.

8) Subrecipients

1. Subrecipients should comply with State Controller Guidance for Federal Requirements for Subrecipients.
2. Subrecipients must comply with 2 CFR 200.
3. Subrecipients' documented procurement procedures must conform to the procurement standards identified in §§ 200.317 through 200.327 (2 CFR § 200.318 (a)).

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4. Subrecipients must comply with their procurement requirements if they are at least as restrictive as the requirements in 2 CFR 200. Otherwise, if their standards are not compliant with federal rules they must follow the federal rules when using federal funds.
5. Subrecipients must flow down federal provisions to tier 2 subrecipients.
6. Subrecipients shall comply with the section of this Policy entitled "Federal Interest in the Property."
7. State agencies have responsibility to monitor subrecipients for compliance with 2 CFR 200 and relevant portions of this Policy.


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