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**PROGRAM INSTRUCTION**

**TO:** All Head Start and Early Head Start Grantees

**SUBJECT:** Responses to Facility Questions Concerning Acquisition, Rent, and Major Renovations

**INSTRUCTION:**

The purpose of this issuance is to respond to a number of questions raised by Head Start grantees in recent years concerning allowable and unallowable charges to Head Start grants for facility acquisition, major renovations, rent, and related topics. The answers provided are intended to provide general guidance only. A comprehensive understanding can only be achieved by a full reading of the applicable regulations and applying them to the circumstance being considered.

Specific Head Start facility related law and regulation appear in the Head Start Act as Section 644(f) and (g); 45 CFR Part 1309; and 45 CFR Parts 74 and 92, respectively. Other relevant regulations appear in or below the questions and answers which follow.

**Approval: Is a Head Start grantee required to obtain prior approval from the Office of Head Start before it can expend federal funds to acquire (purchase or construct) a Head Start facility, or make major renovations to an existing facility?**

Yes. A Head Start grantee must obtain prior written approval from an authorized Department of Health and Human Services/Office of Head Start (HHS/OHS) official before it can expend federal Head Start funds for the acquisition (including either construction or purchase), or major renovation of a facility. Delegate agencies are not directly eligible for assistance in purchasing, constructing or for making major renovations to existing facilities under section 644(f) and (g) of the Head Start Act.

Grantees, however, are eligible under those provisions to receive funding for purchasing, constructing or for making major renovations to existing facilities that will be used by delegate agencies to conduct Head Start programs with the title to the facility being held by the grantee. Prior written approval is separate from an approved Notice of Financial Assistance. Failure to obtain specific prior written approval could result in the disallowance of all associated costs.

**Notice of federal interest: When is a grantee required to file a Notice of Federal Interest for a Head Start facility?**

Under 45 CFR 1309.21 there must be a Notice of Federal Interest whenever grant funds are used to purchase, construct or make major renovations to a facility, including when the facility is a modular unit classified as personal property.

**Collateral: May a Head Start grantee pledge a Head Start facility as collateral for a loan?**

No. Grantees should be aware that a property which is acquired with Head Start grant funds may not be refinanced or used as collateral without the prior written approval of the authorized HHS/OHS official. Under some very limited circumstances, ACF may subordinate the federal interest in facilities purchased or constructed, or which have received major renovations paid for with Head Start funds. For information on ACF subordination of interests in such facilities please see 45 C.F.R. § 1309.21(a) and (f).

45 C.F.R. 74.30 through 37; 45 C.F.R. 92.30 through 37; 45 C.F.R. § 1309.20 through 23.

**Interest Expense: According to OMB Circular A-122, Appendix B, 2 CFR Part 230, Appendix B, interest on debt incurred after September 29, 1995 to acquire or replace capital assets used to support Federal awards is an allowable cost to a federal grant. If a Head Start grantee pays the down payment and the mortgage principal payments with funds from non-federal sources and only charges the Head Start grant for the mortgage interest payments, would the grantee avoid the requirements of 45 CFR 1309, including the filing of federal interest in the facility?**

No. Section 644(f) and (g) of the Head Start Act requires that grantees receive prior approval before using grant funds for purchase, construction, or major renovation of Head Start facilities, including "through payments made in satisfaction of a mortgage agreement (both principal and interest)..." These requirements of the Head Start Act are implemented through the Head Start regulations in 45 C.F.R. Part 1309 and take precedence over the provisions of OMB Circular A-122, Appendix B, ¶ 23, 2 CFR Part 230, Appendix B, ¶ 23 for nonprofit grantees and OMB Circular A-87, Appendix B, ¶ 23, 2 CFR 225, Appendix B, ¶ 23 for governmental organizations.

**Lease/purchase: Can a grantee avoid the requirements of 45 CFR Part 1309, including, for example, the detailed approval process and the filing of a federal interest in a facility, by entering into a lease/purchase agreement for a Head Start facility?**

No. The requirements of 45 CFR Part 1309, including prior approval requirements and the filing of a federal interest in a facility, cover all arrangements through which a grantee uses Head Start funds to purchase, construct or make major renovations to a facility. A lease/purchase agreement, also referred to as a capital lease or a lease with a bargain purchase option, is considered the equivalent of a purchase. Failure to secure prior approval can result in disallowed costs.

**Rental costs: When is it allowable for a grantee to charge rental costs to its grant for a Head Start facility?**

Many grantees charge their Head Start grants for costs associated with the rental of space in which to operate their Head Start programs either as a federal or a non-federal cost. Generally, under OMB Circular A-122 "rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and, the type, life expectancy, condition, and value of the property leased." OMB Circular

A-122, Appendix B, ¶ 43.a. The Circular also states that "[r]ental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available." The same standard is applicable to State and local government recipients and Indian Tribes under OMB Circular A-87, Appendix B, ¶ 37.a.

Space "rental costs" are not allowable when the cost is "assessed" by the organization which is the grantee. A grantee cannot "rent" space to itself. A grantee is limited to charging the grant either depreciation or a use allowance (up to 2% of the acquisition cost per year) for the use of grantee owned space for operations of the Head Start program. Any method, other than the two just mentioned, is not permitted. Any other factors, for example the estimated market rental costs for similar space are not material and have no bearing on the costs the grantee may charge to the Head Start grant. OMB Circular A-122, Appendix B, ¶ 11.g(1), OMB Circular A-87, Appendix B, ¶ 11.f(1).

Where one party to a lease or other rental agreement can control or substantially influence the actions of the other, the lease or agreement will be considered a "less-than-arm's-length" agreement. OMB Circular A-122, Appendix B, ¶ 43.c, OMB Circular A-87, Appendix B, ¶ 37.c. Allowable costs under such agreements are limited to the amount which would be allowable if the grantee held title to the property, i.e. depreciation or a use allowance (up to 2% of the acquisition cost per year). OMB Circular A-122, Appendix B, ¶ 11.g(1), OMB Circular A-87, Appendix B, ¶ 11.f(1). Under OMB Circulars A-112, "[s]uch leases include, but are not limited to those between divisions of a non-profit organization; non-profit organizations under common control through common officers, directors, or members; and an organization and a director, trustee, officer or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest." OMB Circular A-122, Appendix B, ¶ 43.c. A similar statement appears in OMB Circular A-87, Appendix B, ¶ 37.c.

**Funding: What sources of funding, in addition to federal funding through the Office of Head Start, can grantees apply for to acquire a Head Start facility or to pay for major renovations to an existing facility?**

Head Start agencies have obtained funding for facilities acquisition and renovation from a number of sources, including the following:

- U.S. Department of Agriculture, Rural Development, Housing and Community Facilities Programs (HCFP) loans
- U.S. Department of Housing and Urban Development, Community Development Block Grant (CDBG)
- Local Public Housing Authority (PHA) loans
- Public School Capital Building Funds
- Tax Exempt Bond Loans
- State, County or City grants and loans
- Donations of land, facilities, materials or services
- Low Income Investment Fund
- Bank loans
- Proceeds from sale of land or buildings
- Private foundations

Grantees are reminded that utilization of any of the listed sources along with Head Start funds to purchase, construct, or make major renovation to a facility may raise additional issues which will have to be considered by OHS when the grantee applies for prior approval to use Head Start grant funds for a facility project.

**Disposition: Are grantees required to obtain written Regional Office disposition instructions before selling or disposing of a Head Start facility if grant funds were used for purchase, construction, or major renovation?**

Yes. Under 45 CFR 74.32(b) and (c), and 45 CFR 92.31(b) and (c), whenever real property is no longer needed for the originally authorized purpose, the grantee must contact their Regional Office to request disposition instructions from the authorized HHS/OHS official.

**Record retention: How long should grantees retain records related to facility acquisition or major renovation?**

Under 45 CFR 1309.41, grantees must retain all records that pertain to the acquisition or major renovation of a facility for the period of the grantee's ownership (or occupancy in the case of leased facilities) of the facility plus three additional years. This requirement applies whenever any Head Start grant funds are used for the acquisition of facilities or major renovations.

**Technical assistance: Does OHS make any technical assistance resources available to Head Start grantees that have questions about facilities?**

Yes. OHS provides technical assistance through the Head Start Resource Center (HSRC). There is a toll-free phone number to call for assistance regarding questions about facilities: (800) 303-0705.

Please direct any questions on this Instruction to your OHS Regional Office.

/Yvette Sanchez Fuentes/

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