Department of Homeland Security
Office of Inspector General

FLETC Leases for Dormitories 1 and 3

OIG-10-02

October 2009

Office of Inspector General

U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

October 19, 2009

MEMORANDUM FOR: Connie L. Patrick
Director
Federal Law Enforcement Training Center

Richard L. Skinner

FROM: Richard L. Skinner
Inspector General

SUBJECT: *Letter Report: FLETC Leases for Dormitories 1 and 3 (OIG-10-02)*

We initiated an audit of the Federal Law Enforcement Training Center's (FLETC) lease classification for dormitories 1 and 3 at the Glynco, Georgia, facility. The objective was to verify whether FLETC properly classified the leases as operating leases for dormitories 1 and 3 in accordance with Office of Management and Budget Circular A-11, *Preparation, Submission, and Execution of the Budget.*

FLETC properly classified the leases for dormitories 1 and 3 as operating leases under Circular A-11, and thus there is no *Anti-deficiency Act* violation related to the classification of these leases.

Consistent with our responsibility under the *Inspector General Act, as amended,* we are providing copies of our report to appropriate congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. The report will be posted on our website.

Should you have any questions, please call me, or your staff may contact Anne L. Richards, Assistant Inspector General for Audits, at (202) 254-4100.

Background

The Federal Law Enforcement Training Center (FLETC) serves as an interagency law enforcement training organization for more than 80 federal agencies. FLETC operates a residential training site in Glynco, Georgia. Its mission is to train those who protect our homeland.

In the late 1990s, FLETC experienced a growth in its student population that exceeded its ability to house students at its Glynco facility. FLETC subsequently requested and received delegated authority from the General Services Administration to procure up to four 20-year build/lease hotels to house students. In April 2001, FLETC awarded the first of three build/lease solicitations for the construction of a single 300-room hotel-like dormitory facility. FLETC's demand for student housing escalated following the attacks of September 11, 2001. FLETC responded to this demand by using the previously delegated General Services Administration authority to enter into a second build/lease agreement in October 2001 and a third build/lease agreement in September 2002.

FLETC initially classified all three leases as operating, using the income appraisal method to determine the fair market value of each dormitory. However, the Office of Management and Budget (OMB) advised FLETC that it must use the government's estimate of the cost to construct each dormitory to determine its fair market value. When FLETC re-examined the leases using the estimated cost-to-construct method, it determined that lease 2 should have been classified as a capital lease, while leases 1 and 3 remained operating leases.

The classification of a lease affects the dollar amount that should be recognized and recorded as an obligation at the time an agency signs a contract or enters into a lease. Specifically, an operating lease requires obligating funds to cover the lease payments for each year on an annual basis. However, a capital lease requires obligating funds to cover the net present value of the total cost of the lease and property taxes for the period of the lease (but not for imputed interest and identifiable annual operating expenses) at the time the lease is signed.

FLETC's reclassification of the second dormitory as a capital lease caused the required obligation for this lease to exceed FLETC's appropriation authority, resulting in an *Anti-deficiency Act* violation. The act prohibits a government officer or employee from making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law.

In FY 2008, the Department of Homeland Security (DHS) Secretary reported the violation with regard to the second FLETC lease to the President of the United States, the President of the Senate, the Speaker of the House of Representatives, and the Comptroller General, as required by 31 U.S.C. Section 1351, *Reports on Violations*. The department did not report FLETC's other two similar building leases as *Anti-deficiency Act* violations. We performed this audit to evaluate independently whether FLETC's determination of the building leases for dormitories 1 and 3 should be classified as operating leases.

Results of Audit

Based on our analysis and calculation, FLETC properly classified the leases for dormitories 1 and 3 as operating leases. OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, establishes guidance for proper classification of leases as either operating or capital. According to OMB Circular A-11, an agency must apply six criteria to determine whether a lease is an operating or capital lease. All six criteria must be met for a lease to be classified as operating.

We examined the FLETC documents to determine whether FLETC properly applied the six criteria for classifying the leases for dormitories 1 and 3. Based on our analysis, these leases met all six of the criteria needed to qualify as operating leases under OMB Circular A-11, as explained below. Thus, there was no *Anti-deficiency Act* violation related to these two leases.

- **Criterion 1. Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the government at or shortly after the end of the lease term.** The leases for dormitories 1 and 3 do not provide for the transfer of ownership to FLETC at or shortly after the end of the lease term.

- **Criterion 2. The lease does not contain a bargain-price purchase option.** The leases for dormitories 1 and 3 do not contain a bargain-price purchase option.

- **Criterion 3. The lease term does not exceed 75% of the estimated economic life of the asset.** The estimated useful life for dormitories 1 and 3 is 30 years, and both leases are for 20 years with no option for renewal. Therefore, each lease term is 66.67% (20 years/30 years) of the estimated economic useful life for each dormitory.

- **Criterion 4. The asset is a general-purpose asset rather than being for a special purpose of the government and is not built to unique specifications of the government lessee**. According to the contract solicitation and award, the contractor was to provide a "hotel-type facility." FLETC awarded performance-based lease/build contracts for the construction of both dormitories. Each lease required that the lessor construct an "overnight accommodations facility consisting of approximately 134,100 rentable square feet, providing 300 overnight suite-type rooms, together with required surface parking spaces." Dormitories 1 and 3 were not constructed to the unique specifications of the government or for a special government purpose. The dormitories are general-purpose assets that could easily be used as hotels.

- **Criterion 5. There is a private sector market for the asset**. The dormitories could easily be used as hotels. They are located in Brunswick, Georgia, near the resort areas of St. Simons Island and Jekyll Island. The dormitories are not situated on federal government land, and there is a private sector market for the dormitories.

- **Criterion 6. The present value of the minimum lease payments over the life of the lease does not exceed 90% of the fair market value of the asset at the beginning of the lease term.** OMB Circular A-11, Appendix B, provides guidelines for calculating the terms of the leases and the value of the minimum lease payments. Table 1 shows our calculations of the present value of the minimum lease payments over the life of the lease, the lease key terms, and the fair market value for dormitories 1 and 3.

Table 1. Value of Dormitories 1 and 3

	Dormitory 1	Dormitory 3
Monthly Lease Payment	$167,802.08	$174,888.75
Minimum Lease Payment (MLP), monthly [1]	$132,901.00	$148,171.00
Life of the Lease [2]	20 years (240 payments)	20 years(240 payments)
Annual Discount Rate [3]	5.35%	5.45%
Fair Market Value (FMV)	$22,727,075.00 [4]	$24,428,848.19 [5]
Present Value (PV) of MLP [6]	$19,560,288.36	$21,628,706.95
PV of MLP Percentage of the FMV	86.07%	88.54%

As noted above, the present value of the minimum lease payments over the life of the leases was calculated to be 86.07% of the fair market value for dormitory 1 and 88.54% of the fair market value for dormitory 3. These leases do not exceed 90% of the fair market value and meet the criteria.

Management Comments and OIG Analysis

[1] The minimum lease payment is the amount of the monthly lease payment required by the lease less property taxes and identifiable operating expenses.
[2] The lease term is 20 years and requires a monthly payment in arrears, so there are 240 payments (20 years 20 years x 12 months per year).
[3] The annual discount rate was obtained from OMB Circular No. A-94, *Guidelines and Discount Rates for Benefit Cost Analysis of Federal Programs*. Circular A-94 does not include nominal interest rates for 20-year maturities, so we averaged the 10- and 30 -year nominal rates applicable in the year the respective leases were signed.
[4] The fair market value for dormitory 1 was based on FLETC's estimate of the cost to construct the facility. An independent architecture and engineering firm developed the cost -to -construct estimate.
[5] FLETC did not obtain a cost -to -construct estimate for dormitory 3. However, dormitory 3 is very similar in size, space, and other physical characteristics to dormitory 1. We used the independent cost -to -construct estimate for dormitory 1 and adjusted for inflation and additional excavation costs.
[6] The present value is the total amount that a series of future payments is worth now.

We obtained written comments on a draft of the report from the Director of the FLETC. We have included a copy of the comments in Appendix B. The Director has accepted this report without qualification. We consider this matter closed, and no further response is required.

Appendix A
Purpose, Scope, and Methodology

The objective of our review was to verify whether FLETC properly classified the leases as operating leases for dormitories 1 and 3 under OMB Circular A-11, *Preparation, Submission, and Execution of the Budget.*

To determine whether FLETC properly classified the leases, we reviewed (1) OMB Circular A-11, (2) the *Anti-deficiency Act*, (3) the FLETC leases for dormitories 1 and 3, and (4) independent estimates of the fair market value of the buildings. In addition, we calculated the present value of the minimum lease payments over the life of the lease for each dormitory. We also interviewed FLETC's chief financial officer, deputy chief financial officer, and acting chief counsel.

The scope of our audit was limited to verifying FLETC's compliance with OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, and determining whether there were potential violations of the *Anti-deficiency Act*. We did not review FLETC's classification of the leases with respect to DHS' or FLETC's financial statements, or FLETC's compliance with the Statements of Federal Financial Accounting Standards. We did not review FLETC's internal control over financial reporting.

We performed the audit at the FLETC facilities in Glynco, Georgia, from November 2008 to July 2009.

We conducted this performance audit in accordance with generally accepted government auditing standards except for the limited scope identified above. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Federal Law Enforcement Training Center
U. S. Department of Homeland Security
1131 Chapel Crossing Road
Glynco, Georgia 31524

Homeland Security

SEP 21 2009

MEMORANDUM FOR: Anne L. Richards
Assistant Inspector General for Audits

FROM: Connie L. Patrick
Director

SUBJECT: Draft Letter Report: FLETC Leases for Dormitories 1 and 3
FOR OFFICIAL USE ONLY (FOUO)

We accept the report without qualification. We do not have a problem with the report being released to the public.

cc: Richard L. Skinner
Inspector General

Appendix C
Major Contributors to This Report

Jewel Butler, Director, Customs and Revenue
John McCoy, Director, Financial Management
David Porter, Lead Auditor
Maryann Pereira, Desk Officer, Customs and Revenue
Gary Alvino, Independent Referencer

Department of Homeland Security

Secretary
Deputy Secretary
Chief of Staff for Policy
Chief of Staff for Operations
General Counsel
Executive Secretary
Director, GAO/OIG Liaison Office
Under Secretary, Management
Assistant Secretary for Office of Policy
Assistant Secretary for Office of Public Affairs
Assistant Secretary for Office of Legislative Affairs
DHS Audit Liaison

Federal Law Enforcement Training Center

Director

Office of Management and Budget

Chief, Homeland Security Branch
DHS OIG Budget Examiner

Congress

Congressional Oversight and Appropriations Committees, as appropriate

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To obtain additional copies of this report, please call the Office of Inspector General (OIG) at (202) 254-4100, fax your request to (202) 254-4305, or visit the OIG web site at www.dhs.gov/oig.

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- Fax the complaint directly to us at (202) 254-4292;
- Email us at DHSOIGHOTLINE@dhs.gov; or
- Write to us at:

  DHS Office of Inspector General/MAIL STOP 2600,
  Attention: Office of Investigations - Hotline,
  245 Murray Drive, SW, Building 410,
  Washington, DC 20528.

The OIG seeks to protect the identity of each writer and caller.

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cc: Richard L. Skinner
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Major Contributors to This Report

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Department of Homeland Security

Secretary
Deputy Secretary
Chief of Staff for Policy
Chief of Staff for Operations
General Counsel
Executive Secretary
Director, GAO/OIG Liaison Office
Under Secretary, Management
Assistant Secretary for Office of Policy
Assistant Secretary for Office of Public Affairs
Assistant Secretary for Office of Legislative Affairs
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Director

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Congressional Oversight and Appropriations Committees, as appropriate