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# FACILITIES GUIDANCE

## ATTACHMENT A

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## OVERVIEW

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The Office of Head Start (OHS) is committed to the provision of services in good quality facilities with safe indoor and outdoor learning environments. This guidance is intended to support grantees in understanding the Head Start application and funding process for facilities activities. Head Start base grant funds in approved budgets may be used for the payment of rent under operating leases<sup>i</sup> and for repairs<sup>ii</sup> and minor renovations<sup>iii</sup> to facilities. Other facilities activities, including purchase, construction, and major renovations, as defined in [45 CFR § 1305.2](#), require separate application for funding, as described in [45 CFR § 1303.44](#) and [45 CFR § 1303.45](#).

In this guidance, the term "Head Start" is used inclusively for Head Start, Early Head Start, and the Early Head Start-Child Care Partnerships. Regulations applicable to facilities activities funded by OHS are found primarily at [Subpart E, Facilities, 45 CFR § 1303](#) of the Head Start Performance Standards (HSPPS); [Real Property, 45 CFR § 75.318](#) of the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Health and Human Services (HHS) Awards (the Uniform Guidance); and the HHS Grants Policy Statement (GPS), including subsequent revisions or amendments. Additional guidance is available on the Head Start Early Childhood Learning and Knowledge Center (ECLKC) website: <https://eclkc.ohs.acf.hhs.gov/hslc>.

## AVAILABILITY OF FUNDS

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Grantees are encouraged to submit applications for needed facilities activities so that real property needs can be fully understood by OHS. However, OHS has limited funds available for one-time funding applications and typically cannot fund all requests for facilities activities. Requests for facilities funding will be subject to funding priorities established by OHS and reflected in funding opportunity announcements.

## PLANNING

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A design guide and other materials to support planning for real property activities are available on [ECLKC](#). Grantees are encouraged to engage in careful planning to assure that proposed real property activities address identified health and safety issues, reflect the results of community assessment and are eligible for funding under [45 CFR §1303.42](#).

Grantees may submit a written request for funding under [45 CFR §1303.43](#) to determine preliminary eligibility of a planned real property activity in advance of submitting a full facilities application under [45 CFR §1303.44](#) and [45 CFR §1303.45](#). Preliminary activities might include feasibility studies, cost estimates and initial indoor and outdoor environmental testing to assure suitability of the facility project being considered. Grantees are encouraged to discuss facilities



projects with their Regional Program Specialist and Fiscal Operations Specialist well in advance of submitting a full application under [45 CFR §1303.44](#) and [45 CFR §1303.45](#).

## **APPLICATIONS**

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Grantees may submit an application to use Head Start funds to purchase<sup>iv</sup> or construct<sup>v</sup> facilities, and for major renovation<sup>vi</sup> of facilities owned by the grantee or leased from a third party. Applications for facilities funding require the use of real property Form SF-429 (Cover Page) accompanied by Attachment SF-429-B (Request to Acquire, Improve or Furnish). Additional information needed to meet the requirements of [45 CFR §1303.44](#) and [45 CFR §1303.45](#) must accompany the Form SF-429 and Attachment SF-429B. Note that a separate application is not required for repairs or for minor renovations, as defined in [45 CFR §1305.2](#), but such activities may require prior written ACF approval if they meet the conditions of [45 CFR §75.308](#). An example is a kitchen repair that includes the purchase of equipment for which prior written approval is required by [45 CFR §75.308\(c\)\(1\)\(xi\)](#).

## **FEDERAL INTERESTS**

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A federal interest<sup>vii</sup> in real property is created when a grantee uses Head Start or other federal funds to purchase or construct real property<sup>viii</sup> or conduct major renovations on leased or owned property. Protection of the federal interest is required by the HSPPS, [45 CFR §75.323](#) and GPS, page II-67. The federal interest includes total project costs paid with federal funds, those amounts awarded directly from the OHS and amounts claimed by the grantee as cost sharing or matching for the project. [45 CFR §1305.2](#), definition, *Federal interest*.

Grantees are required to file a notice of federal interest in the official real property records for the jurisdiction in which the real property is or will be located, except modular units. [45 CFR §1303.46\(b\)\(1\)-\(3\)](#). Notices of federal interest for modular units must be posted on modular units. [45 CFR §1303.46\(b\)\(4\)<sup>ix</sup>](#). Detailed requirements for timing, content, where to file or post notices of federal interest and instructions for submitting copies of filed or posted notices are included in the HSPPS at [45 CFR §1303.46](#) through [45 CFR §1303.49](#). A federal interest cannot be defeated by a grantee's failure to file a required notice of federal interest. [45 CFR §1303.46\(a\)](#).

## **REPAIRS, MINOR RENOVATIONS AND MAJOR RENOVATIONS**

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Grantees should familiarize themselves with the definitions of these terms in [45 CFR §1305.2](#). Repairs and minor renovations, as defined, do not result in a federal interest, and do not require the filing of a notice of federal interest. Major renovations require full compliance with [45 CFR §1303](#) (Subpart D). While not common, it is anticipated that a grantee may engage in repairs, the



aggregate value of which exceeds \$250,000. In the event that a grantee proposes to spend more than \$250,000 for repairs, the grantee must submit to ACF, in advance of commencing the proposed repairs, a certification from a licensed, independent architect or engineer indicating that the expenditures identified as repairs do not add significant value to the real property to be repaired or extend its useful life. If the required certification is not provided, the activity will be classified as a major renovation and compliance with [45 CFR §1303](#) (Subpart D) is required.

[Sec. 644\(g\)\(3\)](#) of the Head Start Act applies the Davis-Bacon and Related Acts ([40 USC 276a et seq](#)) to contractors and subcontractors engaged in covered construction and renovation activities in excess of \$2,000 on facilities used to carry out Head Start activities. Covered Davis-Bacon Act activities are construction, alteration, or repair (including painting or decorating). If Head Start funds in excess of \$2,000 are used toward the cost of covered activities, the Davis-Bacon Act applies. Grantees engaging in facilities activities of any type should familiarize themselves with the requirements of the Davis-Bacon Act to assure compliance. Compliance resources are available from the US Department of Labor: <https://www.dol.gov/whd/govcontracts/dbra.htm>.

## **FINANCING, REFINANCING AND PLEDGES OF COLLATERAL**

Prior ACF approval is required in all circumstances in which real property subject to a federal interest is pledged as collateral. [45 CFR §1303.48\(a\)](#). Such circumstances include mortgages, refinancing of existing facilities debt and general or “blanket” pledges of collateral. Grantees requesting prior approval to use property subject to a federal interest as collateral must submit real property Form SF-429 (Real Property Status Report, Cover Page) and SF-429-C (Disposition or Encumbrance Request).

The HSPPS require that loan agreements with third party lenders for property subject to a federal interest contain language providing ACF with certain rights as described in [45 CFR §1303.49\(a\)\(1\)-\(7\)](#). These include notice of any borrower default in payment or performance, an opportunity to cure the default and the right to direct assignment of the loan to another grantee. In addition, grantees are also required to immediately notify ACF of any default in a loan agreement secured by property subject to a federal interest. [45 CFR §1303.49\(b\)](#). Grantees successfully competing for a new service area may be required by OHS to accept assignment of loans associated with facilities continuing in Head Start use.

Grantees should be aware that loans with short-term maturity dates of less than 15 years (interest-only and balloon loans) will not generally be approved by ACF. A capital lease resulting in acquisition of title to real property<sup>x</sup> requires prior ACF approval and will only be considered in those rare instances in which the grantee acquires title to the property and the cost of acquisition of title under the capital lease does not exceed the fair market value of the property at the time the capital lease is or was entered into. As noted below, absent prior ACF approval of a capital lease, rental costs under leases which are required to be treated as capital leases under Generally Accepted Accounting Principles (GAAP) are allowable only up to the amount that



would be allowed had the non-federal entity purchased the property on the date the lease agreement was executed. [45 CFR §75.465\(c\)\(5\)](#).

## **SUBORDINATION AGREEMENTS**

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A subordination agreement is a legal contract between ACF and a lender that allows the lender to establish first lien status on property already subject to a federal interest. Only ACF can agree to a subordination of the federal interest to the rights of a lender. Common situations where subordination agreements are requested include use of Head Start funds as a down payment with an accompanying mortgage for the balance of the purchase price and when property subject to an existing mortgage is refinanced after acquisition.

Grantees requesting a subordination agreement from ACF must submit real property Form SF-429 (Real Property Status Report, Cover Page) and SF-429-C (Disposition or Encumbrance Request). In addition, when the amount of federal funds already contributed to the facility prior to the subordination requires exceeds the amount to be provided by the lender seeking subordination, [45 CFR §1303.51](#) requires the grantee to show that funding is not available without subordination of the federal interest. This could be shown, for example, by a letter from the proposed lender stating that it will not fund the proposed loan without subordination of the federal interest.

Grantees are encouraged to consult their Regional Grants Specialist prior to submitting a subordination request to assure that the proposed subordination agreement includes all required terms and conditions, and that all supporting materials, including an independent appraisal of the current fair market value of property at issue and proposed loan documents, are completed and available to accompany the subordination request.

## **LEASES**

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Leases for facilities are classified for accounting purposes as either operating leases or capital leases. To determine allowable costs, property subject to a capital lease is treated as though it were owned by the grantee, [45 CFR §75.465\(c\)\(5\)](#) while the reasonable costs of operating leases are ongoing operating expenses<sup>xi</sup>. Capital leases resulting in the acquisition of title by the lessee (grantee) are sometimes referred to as lease-purchase agreements.

Sale and leaseback agreements are treated similarly to capital leases. [45 CFR §75.465\(c\)](#). In addition, if the a grantee is party to a less-than-arms-length lease as described in [45 CFR §75.465\(c\)\(1\)-\(4\)](#) charges against the Head Start award are also limited in accordance with [45 CFR §75.436](#).



Rental costs under capital leases (except where previously approved in writing by ACF as a purchase) sale and leaseback agreements and less-than-arms-length lease arrangements are allowable only up to the amount that would be allowed had the grantee owned the leased property. This amount includes expenses such as depreciation, maintenance, taxes (if the grantee is not exempt) and insurance. [45 CFR §75.436](#).

## DEPRECIATION

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Grantees may charge their Head Start award for allocable and allowable depreciation of facilities used for Head Start program purposes. [45 CFR §75.436](#). Allowable annual depreciation is generally the acquisition cost of a facility (excluding land) divided by the useful life of the facility as established in the grantee's financial statements. Depreciation must be adjusted (allocated) to reflect the extent of Head Start usage of the facility and cannot include any portion of the cost of the facility (acquisition or major renovation) borne through the use of Head Start funds or claimed as non-federal match for Head Start funds. [45 CFR §75.436\(b\)-\(d\)](#).

For example, if the acquisition cost of a grantee-owned facility, excluding land, is \$800,000 and its useful life is 40 years, allowable annual depreciation is \$20,000 per year if the facility is used 100 percent for Head Start purposes and no federal funds or non-federal match have contributed to the acquisition cost of the facility.

**Scenario 1:** If only 60 percent of the facility is used for Head Start services, the amount of annual allowable depreciation noted above must be reduced to 60 percent of the otherwise allowable amount, resulting in depreciation of \$12,000.

**Scenario 2:** If 30 percent of the cost of the facility was paid with Head Start funds, 30 percent of the amount of annual allowable depreciation noted above must be deducted, leaving 70 percent of the otherwise allowable amount or \$14,000.

**Scenarios 1 and 2 Combined:** If only 60 percent of the facility is used for Head Start proposes *and* 30 percent the cost of the facility was paid with Head Start funds, the amount of annual allowable depreciation noted above must be adjusted for both extent of Head Start use and federal share. Step 1: Adjustment for Head Start usage at 60 percent = \$12,000. Step 2: A further 30 percent reduction of the amount arrived at in Step 1 (70 percent x \$12,000) produces final allowable depreciation in the amount of \$8,400.

Charges for depreciation must be supported by adequate depreciation and property records, and physical inventories must be taken at least once every two years. [45 CFR §75.436\(e\)](#). Allowable amounts of annual depreciation may be charged against the grantee's Head Start award or



claimed as non-federal match if the grantee foregoes the charging of otherwise allowable depreciation.

## **REPORTING AND RECORDKEEPING**

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All grantees are required to complete and submit real property status information annually using forms SF-429 (Real Property Status Report, Cover Page) and SF-429-A (Attachment A, General Reporting). Additional information must be reported for each piece of property in which a federal interest exists as that term is defined in [45 CFR §1305.2](#), even if the grantee has not filed or posted the required notice of federal interest. [45 CFR §1303.46\(a\)](#).

Grantees must retain records pertinent to the lease, purchase, construction or renovation of a facility funded in whole or in part with Head Start funds for as long as the grantee owns or occupies the facility, plus three years. [45 CFR §1303.54](#). In the circumstances identified in [45 CFR §75.361\(a\)-\(f\)](#) record retention may be required for periods in excess of three years.

If a grantee is charging depreciation to its Head Start award, those charges must be supported by adequate property records supporting acquisition cost and useful life, and physical inventories must be taken at least once every two years. [45 CFR §75.436\(e\)](#).

## **VALUATION AND MATCHING**

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Whenever current fair market value of real property is established, the determination of value must be made by an independent real property appraiser certified or licensed in the state in which the property is located. [45 CFR §75.306\(i\)\(1\)](#), GPS page II-67. The appraiser must be licensed for the type of property appraised, generally commercial real estate. An appraisal more than three years old cannot be used to establish current fair market value of real property.

Fair market rental value is the amount that a grantee would have to pay to rent comparable space in the community. The claimed value of donated space must not exceed the fair market rental value of comparable space as established by an independent appraisal of comparable space in a privately-owned building in the same locality. [45 CFR §75.306\(i\)\(3\)](#). For purposes of establishing fair market rental value of donated space from an unrelated party, the required fair market rental value may be established by an appraiser as described above, or by a licensed and independent real estate broker or real estate agent familiar with the rental market in the local community. An appraisal more than three years old cannot be used to establish current fair market rental value of donated space.

If space is donated by a related party the amount of matching the grantee may claim is limited to the amount that could have been claimed had the grantee been the titleholder of the property, generally those amounts described in [45 CFR §75.436](#).



## DISPOSITION

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When real property subject to a federal interest is no longer needed for program purposes ([45 CFR §318\(b\)](#)) grantees must request that ACF provide disposition instructions for the property. [45 CFR §318\(c\)](#). Disposition requests are made using Form SF-429 (Real Property Status Report, Cover Page) and SF-429-C (Attachment C, Disposition or Encumbrance Request). ACF may also instruct a grantee to dispose of real property if the grantee is no longer funded to provide services in the area in which the real property is located, such as when a grantee relinquishes its Head Start award, is de-funded by OHS or does not retain the service area as a result of designation renewal competition.

A grantee may request that real property subject to a federal interest be used in another federally sponsored program offered by the grantee with a purpose similar to Head Start. [45 CFR §75.318\(b\)\(2\)](#). If use in another program is not possible or not approved, ACF may direct the grantee to undertake one of three disposition options: The grantee may be instructed to retain title to property subject to a federal interest and compensate ACF for the value of the federal interest in the property. [45 CFR §75.318\(c\)\(1\)](#); ACF may direct the grantee to sell the property with the proceeds to be allocated between ACF and the grantee based on their relative interests in the property. [45 CFR §75.318\(c\)\(2\)](#); or the grantee may be directed to transfer title to a third party with compensation for the value of the grantee's share of the property. [45 CFR §75.318\(c\)\(3\)](#).

With prior ACF approval, [45 CFR §75.318\(c\)\(1\)](#) allows the grantee to use the net proceeds of the sale of property subject to a federal interest to offset the cost of replacement property acquired under the same federal award. Since the option of using proceeds of sale to offset the cost of replacement property did not exist uniformly exist under regulations applicable prior to December 26, 2014, grantees proposing to use proceeds of sale to acquire replacement property must formally adopt [45 CFR Part 75](#) for all of their existing facilities awards, as reflected in fiscal policies and procedures and approved by the Governing Body and Policy Council.

Grantees may indicate their use or disposition preference on the disposition request; however, ACF has the discretion to instruct a grantee to engage in another method of disposition which may better suit program needs. In the event that a disposition instruction requires compensation by ACF of a grantee's share in real property, the grantee must provide documentation of the source, amount and any restrictions or condition associated with funding for any claimed grantee share. Costs of purchase, construction or major renovations to the property previously claimed by the grantee as cost sharing or match to the Head Start award are part of the federal interest. [45 CFR 1305.2](#), definition, *Federal interest*. Failure to comply with disposition instructions issued by ACF may result in denial of close-out funding or adverse action against the grantee.

To determine the current value of the federal interest and grantee share in connection with disposition of real property, current fair market value must be established by an independent real





property appraiser certified or licensed in the state in which the property is located. GPS page II-67. Once current fair market value is established, the value of the federal interest and grantee equity, and, if applicable, other third-party interest or equity, are determined by calculating the respective federal, and grantee, and, if applicable, third party contributions to the property, and applying the resulting percentages to the current fair market value.

All claims of amounts to be included in the calculation of grantee contribution must be adequately documented and cannot include funds or property subject to a third-party use restriction, reversionary interest, encumbrance or similar condition. In the event of disposition requiring ACF compensation of grantee share, it is the responsibility of the grantee to produce adequate documentation to establish grantee equity upon receipt of disposition instructions.

If it is necessary to establish federal interest and grantee equity in connection with a disposition, grantees are encouraged to work closely with their Regional Program Specialist and Grants Specialist throughout the disposition process.

## CONCLUSION

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Use of Head Start funds for purchase, construction and major renovation of real property provides an important opportunity for grantees to assure that services to children and families are provided in good quality facilities that support school readiness and enhance the delivery of comprehensive services. Real property activities funded by OHS represent significant investments in real property intended to benefit children and families in the local community over extended periods of time.

Although grantees are permitted to hold title to real property acquired or improved with OHS funds, the property is held in trust by the grantee as trustee for the beneficiaries of the project or program under which the property was acquired or improved. [45 CFR §75.323](#). Compliance with the requirements of [45 CFR Part 1303](#) (Subpart E) and [45 CFR Part 75](#) is mandatory to assure ongoing availability of real property for program use, and protects the grantee from future risk of audit issues, monitoring findings and potential disallowance of previously awarded funds. Grantees considering real property activities covered by the HSPPS, Uniform Guidance and Grants Policy Statement are encouraged to consult their Program Specialist and Grants Specialist early in the project development process to assure compliance with all of the requirements that apply to real property activities funded by OHS.

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<sup>i</sup> The use of grant funds to make payments under a capital lease, as noted in [45 CFR §75.465\(c\)\(5\)](#) and defined by Generally Accepted Accounting Principles (GAAP) must either be limited to the amount that would be allowed had the non-federal entity purchased the property on the date the lease agreement was executed or, if the grantee will acquire title under capital lease, approved in accordance with [45 CFR §1303.44](#) and [45 CFR §1303.45](#).

<sup>ii</sup> Repair means maintenance that is necessary to keep a Head Start facility in working condition. Repairs do not add significant value to the property or extend its useful life. [45 CFR §1305.2](#).



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- iii Minor renovation means improvements to facilities, which do not meet the definition of major renovation. [45 CFR §1305.2](#).
- iv The term purchase means to buy an existing facility, including outright purchase, down payment or through payments made in satisfaction of a mortgage or other loan agreement, whether principal, interest or an allocated portion of principal and/or interest. The use of grant funds to make a payment under a capital lease agreement, as defined in the cost principles, is a purchase subject to these provisions. Purchase also refers to an approved use of Head Start funds to continue paying the cost of purchasing facilities or refinance an existing loan or mortgage beginning in 1987. [45 CFR §1305.2](#).
- v Construction means new buildings, and excludes renovations, alterations, additions or work of any kind to existing buildings. [45 CFR §1305.2](#).
- vi Major renovation means any individual of collection [sic] renovation that has a cost equal to or exceeding \$250,000. It excludes minor renovations and repairs, except when they are included in a purchase application. [45 CFR §1305.2](#).
- vii Federal interest is a property right which secures the right of the federal awarding agency to recover the current fair market value of its percentage of participation in the cost of the facility in the event the facility is no longer used for Head Start purposes by the grantee or upon the disposition of the property. When a grantee uses Head Start funds to purchase, construct or renovate a facility, or make mortgage payments, it creates a federal interest. The federal interest includes any portion of the cost of purchase, construction or [major] renovation contributed by or for the entity, or a related donor organization, to satisfy a matching requirement. [45 CFR §1305.2](#).
- viii Real property means land, including land improvements, buildings, structures and all appurtenances thereto, excluding movable machinery and equipment. [45 CFR §1305.2](#).
- ix See also [45 CFR §75.323](#).
- x As defined in Financial Accounting Standards (FAS) No. 13 when the lease results in a transfer or ownership at the end of the lease or contains a bargain-purchase option. Other criteria for a capital lease include where the lease term is at least 75% of the estimated economic life of the property and when the present value of payments under the lease exceeds 90% of the fair market value of the property at its inception.
- xi For a full discussion of capital leases, operating leases and other lease arrangements, see FAS No. 13: [http://www.fasb.org/jsp/FASB/Document\\_C/DocumentPage?cid=1218220124481&acceptedDisclaimer=true](http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1218220124481&acceptedDisclaimer=true).

