UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

Released

CIVIL ACCOUNTING AND AUDITING DIVISION

B-96826-O.M.

Feb. 8, 1967

FEB 8 [redacted]

The Comptroller General

During our review for settlement of accounts of accountable officers at the Soil Conservation Service State Office, Bozeman, Montana, questions have arisen concerning the legal propriety of expenditures for alterations and improvements to land and buildings occupied by the Plant Materials Center (PMC), a Soil Conservation Service (SCS) program being carried out near Bridger, Montana. Specifically, we are concerned as to whether the document establishing the use of the land and buildings by SCS can be construed to be a lease, i.e., one lease or two leases, and therefore subject to the limitations of Section 322 of the Economy Act of 1932, as amended (40 U.S.C. 278a); if so, the extent to which "improved land" is involved and what part, if any, of the work performed by SCS on the land and buildings should be classed as alterations or improvements. In the event the transaction is not considered subject to section 322 there is the further question of whether SCS has the authority to expend any funds on alterations and improvements on privately owned land and buildings.

In October 1959, SCS entered into a cooperative agreement with the Carbon County Soil Conservation District of Carbon County, Montana, (the District) for the use of land and buildings near Bridger, Montana, as a PMC. The agreement covered the period October 9, 1959, to June 30, 1960, with options to renew from year to year extending to June 30, 1970. The agreement provides for the District to make available to SCS 80 acres of land at an annual cost of $1,840 per year, plus delivery of water to the 80 acres during the irrigation season for an additional payment of $2 per acre per year or a total of $160 for the 80 acres. The agreement also provides for the use by SCS of four buildings located on land adjacent to the 80 acres; three of the buildings are included at no cost except that SCS is to assume the costs of normal maintenance and repair; the fourth building, a 40' x 80' steel building constructed on a permanent-type 2-foot concrete foundation with a concrete floor, was to be made available at an annual cost of $1,200. Our examination of the subject agreement showed that the District rents the land and the three buildings from the owner for the exact amount that it receives from SCS for the use of these facilities.

Our examination has further shown that SCS exclusively operates the PMC facility. District records show that the steel building (fourth building) was constructed by the District at a cost of about $9,000 which includes interest of about $790 on borrowed funds. Consequently, the District could receive payments of more than $12,000 over the renewal period of the agreement

and therefore could be fully reimbursed for the cost of constructing the steel building. A District official told us that no taxes are levied on the building; no insurance is carried on it; and, at the time of our review, no maintenance costs had been incurred. Copies of the cooperative agreement between SCS and the District, and the lease between the District and owner of the property are enclosed as Attachments 1 and 2. Also, documents showing background and data on the operation of a PMC are enclosed as Attachments 3 through 7.

We note that our Office has stated that it is a well settled rule that appropriated funds may not be used by an agency of the United States for the permanent improvement of privately owned property unless specifically authorized by law.[1] However, an exception to this rule contained in Section 322 of the Economy Act provides in pertinent part as follows:

> "* * * no appropriation shall be obligated or expended for the rent of any building or part of a building to be occupied for Government purposes at a rental in excess of the per annum rate of 15 per centum of the fair market value of the rented premises * * * nor for alterations, improvements, and repairs of the rented premises in excess of 25 per centum of the amount of the rent for the first year of the rental term * * * Provided * * * That the provisions of this section as applicable to rentals, shall apply only where the rental to be paid shall exceed $2,000 per annum."

SCS has administratively established the required elements of a cooperative agreement in their Administrative Services Handbook. It provides that a cooperative agreement is a written instrument evidencing the intent of two or more parties to cooperate in carrying out an undertaking which will result in mutual benefit to the parties concerned, the parties working jointly with no party carrying on or conducting the undertaking to the exclusion of the others. Each party contributes money, materials, equipment, or services (or any combination thereof) to the undertaking. (See Attachment 8.)

Agency officials have informed us (Attachment 9) that the District's major contributions to the PMC operation are (1) the maintenance of the steel building, such as the repair of roof leaks, plumbing repairs, etc., and (2) providing the financing for the construction of the steel building. In our opinion these contributions are no more than those provided under many ordinary landlord-tenant relationships. Fulfillment of the other contributions listed on Attachment 9 calling for District supervisors to plan and schedule tours of the PMC and to schedule or make arrangements for PMC personnel to speak at meetings do not appear to be proper for consideration as contributions to the plant materials program. Also, these contributions were not made

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1/ 15 Comp. Gen. 761; 20 id. 927; 21 id. 906; 25 id. 279.

part of the subject agreement.

Aside from the consideration as to whether the subject agreement which makes available to SCS the land and buildings for operating the PMC is a lease or a cooperative agreement, there is also the question of whether the agreement if considered a lease, should be construed as one lease requiring annual rental payments of $3,040 ($1,840 plus $1,200) or two leases - one for unimproved land and one for improved land (land and buildings).

Early in the development of the subject agreement, the transaction was drafted on a standard lease form. However, correspondence and memorandums obtained from SCS files show that a cooperative agreement was later substituted for the lease form apparently to avoid the applicability of section 322 and thus circumvent questions relating to fair market valuation and monetary limitations on amounts that could be spent to maintain and improve the land and buildings. (See Attachments 16, 17 and 19.)

In operating the PMC since 1955, SCS has developed an extensive irrigation system on the land which involved land leveling and planning; construction of concrete pipelines with structures and gate stands, concrete drop structures, checks, and turnouts; installation of corrugated metal pipe culverts and fencing; and construction of ditches and laterals. In the steel building, SCS has added a complete electrical wiring system, constructed office space which included cutting windows in the building, and built enclosures around the toilet areas. Our observation of the construction in the building disclosed that it consisted of 2" x 4" framing tied into the walls and floors and covered with wallboard or plywood. Photos of the irrigation system construction and building are shown on Attachments 5 and 11 through 14.

Costs of construction, not including labor where construction was performed by SCS personnel, have amounted to about $15,000 on the land and $2,500 on the building (see Attachment 20). An SCS Washington official advised us that, in his opinion, these improvements are not of a permanent nature. According to an SCS State official, the improvements and alterations to the building would have no residual value if removed. Also, we were told that about 60 percent of the irrigation system improvements would have to be destroyed if the land were returned to a farming operation.

If the agreement is considered a lease and subject to section 322 there is also for consideration the extent to which improved lands are involved. In 38 Comp. Gen. 144 it was held that the 25 percent limitation in Section 322 of the Economy Act is not regarded as applicable to unimproved lands leased as such to the Government. However, if the lease is for improved land; i.e., land and buildings, then the 25 percent limitation of section 322 would be applicable whether the repairs, alterations, or improvements are to the land, the buildings thereon, or both, since the limitation is applicable to the rented "premises." It was held further that the word "premises" generally means land with buildings and structures thereon.

The subject agreement appears to segregate the unimproved farm land from the land and buildings; i.e., all buildings being used by SCS are located on lands adjacent to the 80 acres of farm land and not a situation of land with buildings and structures thereon. (See attachment 1 and maps on Attachments 5 and 10.) If the term "premises" is interpreted to exclude the 80 acres of unimproved land, it would appear that the annual payment for the building would be less than $2,000 and therefore the general rule would apply precluding the expenditure of funds on the farm land and buildings without specific authorization by law. The only possible exception to this prohibition would be if the premises were being leased rent free or at a nominal rental. In this situation the cost of the alterations and improvements to the building would be regarded as rent and the total amount thereof plus rent is limited to 15 percent of the fair market value.1/ However, the application of this principle in the instant case would not seem appropriate inasmuch as the land and building are apparently not occupied free of charge or at a nominal rental.

According to SCS officials at the State Office the operation of the PMC is carried out under the basic authorities set out in the Soil Conservation Act of 1935 (16 U.S.C. 590a - 590f). As far as we could determine, no special authorization for operating this plant has been provided by other laws.

It appears that the work on both the land and buildings falls into one of the following two categories, and therefore we believe that the resulting cost should be applicable to either the 25 percent limitation on alterations or improvements or the general rule that appropriated funds may not be used for the permanent improvement of privately owned property:

1. An improvement so built and attached to the realty that it may not be readily removed therefrom without damage to the property and/or equipment.2/

2. An alteration, which is defined as the act or process of altering, an effected change, as for instance, the erection of a partition dividing one room from another, changing the stairway, closing up a door or window, or cutting a new door or window, etc.3/ In this connection, it has been held that while the term "improvements" may connote a resultant benefit to the property or an increase in its value, it would seem that by the term "alterations" also it was intended by the law to circumscribe expenditures for any modifications or changes in leased property irrespective of the extent they might prove useful to the owner thereof.4/

Your advice is requested on the following questions:

1/ 21 Comp. Gen. 906
2/ 3 Comp. Gen. 376; 15 id. 483; 18 id. 144; 20 id. 105
3/ 27 Comp. Gen. 634
4/ 29 id. 279

1. Is the subject agreement a cooperative agreement or a lease? If a lease, is it one lease or two separate leases?

2. If the agreement is considered to involve one lease subject to the provisions of Section 322 of the Economy Act, for which items, if any, is the agency precluded from spending any amount on alterations and improvements on land and building without specific authorization by law?

3. If the agreement is considered to involve two leases and section 322 is applicable, for which items, if any, is the agency precluded from spending any amount on alterations and improvements on buildings or unimproved land without specific authorization by law?

4. If the agreement is considered to involve two leases and section 322 does not apply, for which items, if any, is the agency precluded from spending any amount on alterations and improvements on buildings or unimproved land without specific authorization by law?

5. If the subject agreement is considered a cooperative agreement, is the agency precluded from spending any amount on alterations and improvements on the buildings or the unimproved land without specific authorization by law?

Arthur Schoenhaut

Arthur Schoenhaut
Deputy Director

Attachments
1 through 20

Indorsement

B-96826-O.M. FEB 8 - 1967

Director, Civil Division

Returned. A lease is an agreement whereby the relation of landlord and tenant is created. Willys of Marin Co. v. Pierce, 296 P. 2d 25. No particular phraseology is necessary to create a lease. Lewis v. Ebersole 12 So. 2d 543.

While the cooperative agreement provides that the Soil Conservation District (District) will make available to the Soil Conservation Service (SCS) 80 acres of land, the District in fact rents such land to the Service. Further, it appears from your Division's memorandum that the District rents the land and the three buildings on the adjacent land from the owner thereof for the exact amount it receives from SCS for the use of these facilities. The District also rents to SCS the steel building (fourth building) located on the adjacent land. Moreover, under the agreement between the District and SCS the District would not contribute anything thereunder that is not generally required where a landlord-tenant relationship exists. Furthermore, the other contributions which SCS says the District contributes are not required by, or made part of, the so-called cooperative agreement.

While the cost of the steel building will not be reimbursed to the District if the yearly renewal option is not exercised by SCS any time before rentals in an amount sufficient to amortize the cost of the building are collected from SCS, the building will belong to the District. Further, as pointed out in your Division's memorandum the District could receive payments of more than $12,000 over the renewal period of the agreement, and this amount would exceed construction cost of the steel building by about $3,000.

It is obvious from the foregoing facts that the instrument involved here creates a landlord-tenant relationship between the SCS and the District. While, no doubt, there may be included in a lease, provisions which could reasonably be construed as requiring contributions by the lessor over and above the consideration for the lease, the present instrument does not appear to contain such provisions. The Administrative Services Handbook contemplates that each party to a cooperative agreement will contribute money, materials, equipment or services or any combination thereof to the undertaking. Under the so-called cooperative agreement involved here the District is reimbursed for the land and buildings it furnishes the SCS and is required thereunder to furnish only those services which are provided under many ordinary landlord-tenant relationships. Thus, in our view the instrument involved here is, in effect, a lease agreement.

As to whether the document involved, if not a cooperative agreement, should be considered one lease or two separate leases, the record discloses that two separate and distinct pieces of property and two separate rents are involved, although presumably the document in question covers a "package deal." The steel building used and rented by SCS for $1200 per year is not on the 80 acres of land which the District rents from the owner of the land for $25 per acre (including $2 per acre for water), and which SCS rents from the District for $1,840 per year. The steel building plus

the other buildings used by SCS are located on land on which there is also located the premises occupied by the owner of the land. This land is adjacent to the 80 acres. Thus, as indicated in your Division's memorandum the document involved segregates the 80 acres of farmland from the land containing the premises occupied by the owner and certain other buildings. Accordingly, it is our view that the document in question should be considered as including two separate leases.

Since section 322 of the Economy Act is not applicable to unimproved lands (38 Comp. Gen. 143), it would not be applicable to the lease for the 80 acres of land. The lease for the steel building however, would be subject to section 322. Whether the cost of the electrical wiring system installed in the building must be considered a permanent improvement so as to come within the improvement limitation in section 322 depends on the manner in which the system was installed and whether it may be easily removed without damage to the system or the building, and with little or no cost. There is not sufficient information in the record before us to make such a determination as to the wiring. Cutting windows in the building and constructing office space and toilet enclosures in the manner set forth in your Division's memorandum would constitute alterations to the building and the cost thereof would be for consideration in determining whether the 25 percent limitation in section 322 had been violated.

Concerning application of the general rule (which is one of policy and not of positive law) set forth in our decisions to the effect that appropriated funds may not be used for the permanent improvement of privately owned property, unless authorized by law, section 1(1) of the act establishing SCS, 16 U.S.C. 590a(1), authorizes the Secretary of Agriculture to conduct investigations and research relating to soil erosion and the preventive measures needed. Section 2(b) (16 U.S.C. 590b) provides that the acts authorized in section 1(2) may be performed on any lands upon obtaining proper consent or the necessary rights or interests therein. Section (3) (16 U.S.C. 590c) of the act provides that:

> "SEC. 3. As a condition to the extending of any benefits under this Act to any lands not owned or controlled by the United States or any of its agencies, the Secretary of Agriculture may, insofar as he may deem necessary for the purposes of this Act, require--
>
> "(1) The enactment and reasonable safeguards for the enforcement of States and local laws imposing suitable permanent restrictions on the use of such lands and otherwise providing for the prevention of soil erosion;