

DEPARTMENT OF TRANSPORTATION**Federal Transit Administration****49 CFR Part 639**

[Docket No. FTA-96-1031]

RIN 2132-AA55

Capital Leases

AGENCY: Federal Transit Administration, DOT.

ACTION: Final rule.

SUMMARY: This final rule amends "Capital Leases" to treat maintenance costs under a commercial lease of a capital asset as an eligible capital expense. "Capital Leases" implements section 308 of the Surface Transportation and Uniform Relocation Assistance Act of 1987, which allows capital grants under the Federal transit laws to be used for leasing facilities or equipment if a lease is more cost effective than purchase or construction of such items. FTA believes that this amendment is consistent with industry practice and with recent Federal initiatives to streamline federally assisted procurement practices and to ensure that Federal investment in the nation's transportation infrastructure is properly protected.

EFFECTIVE DATE: June 17, 1996.

ADDRESS: United States Department of Transportation, Central Dockets Office, P-125, 400 Seventh Street, S.W., Washington, D.C. 20590.

FOR FURTHER INFORMATION CONTACT: Rita Daguillard, Deputy Assistant Chief Counsel, Office of Chief Counsel, (202) 366-1936, or Douglas Kerr, Office of Program Guidance and Support, (202) 366-1656.

I. Supplementary Information**A. Background**

Under 49 U.S.C. 5307, Federal funds are provided to urbanized areas on the basis of a statutory formula. These funds are available for the acquisition or construction of mass transportation facilities and equipment ("capital assistance grants"), as well as for payment of a portion of the net operating cost of mass transportation facilities and equipment ("operating assistance grants").

Historically, Federal Transit Administration (FTA) recipients had the discretion to acquire capital assets by long-term or short-term lease, but few did so, since the significant portion of the lease cost (as much as forty percent) representing imputed interest was ineligible for reimbursement under

Office of Management and Budget (OMB) cost principles (OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments").

In 1987, section 308 of the Surface Transportation and Uniform Relocation Assistance Act, Public Law 100-17 (STURAA), expressly authorized the use of section 5307 capital assistance funds to acquire facilities and equipment by lease where leasing is more cost effective than purchase or construction. As explained in the accompanying Senate Report, section 308

permits grantees to use [section 5307] grant funds to lease major capital cost items such as computers, maintenance of way and other heavy equipment, maintenance of effort rail equipment, radio equipment, bus garages, property or structures for park and ride, and other buildings or facilities used for mass transit purposes. The Committee recognizes that it is often more cost effective for grantees to lease rather than purchase major capital items. Leasing arrangements can also provide transit authorities with flexibility that is needed, for example, to maintain technological advance in their communications and computing equipment or to adapt buildings and other facilities to changing needs. By including this section, the Committee intends to help grantees better manage their operations and conduct long-term and short-term planning.

S. Rep. No. 3, 100th Cong., 1st Sess. 6 (1987).

On October 15, 1991, FTA issued 49 CFR Part 639 (56 FR 51786), which implements section 308. The rule provides that capital grants under section 5307 may be used for leasing facilities or equipment if leasing is more cost effective than purchase or construction of such items. Section 639.27 lists maintenance costs among the factors that a recipient may consider in making its cost-effectiveness determination. Section 639.17, provides that "only costs directly attributable to making a capital asset available to the lessee are eligible for capital assistance" and cites as examples finance charges and ancillary costs such as delivery and installation charges.

B. The Notice of Proposed Rulemaking

On January 31, 1996, FTA issued a notice of proposed rulemaking (NPRM) that would amend section 639.17 to recognize maintenance costs as "costs directly attributable to making a capital asset available to the lessee." In the NPRM, FTA stated that this amendment appeared to be consistent with common industry practice and Federal procurement streamlining measures.

The NPRM pointed out that in reviewing the subject of capital leases, particularly vehicle leases, FTA had noted that maintenance and repair costs

are often an integral component of standard commercial lease agreements and that use of capital assistance for such costs is expressly permitted under section 5307. Many commercial vehicle leases, for instance, state that the lessor will provide all maintenance, repairs, and replacement parts needed to keep the capital asset in good operating condition. These services are included in the overall lease cost, rather than being itemized as a separate charge. In such cases, it is not feasible for lessees to separate maintenance charges from the overall lease cost. The NPRM stated that requiring grantees to do so imposes an accounting burden that is inconsistent with Congress' recognition that leasing is often more cost effective and with its intention in section 308 to facilitate grantee operations.

The NPRM moreover noted that since regular maintenance is necessary to ensure the availability and adequate functioning of a capital asset, FTA believes that it is an essential and inseparable element of the lease agreement. Congress has expressly recognized this relationship in allowing capital assistance to be used to acquire "associated capital maintenance items" under section 5307(b)(1), where such items would otherwise have to be funded under the operating assistance program. FTA therefore proposed to recognize maintenance charges as eligible capital costs under a commercial lease directly attributable to the lessee's use of the asset within the definition of section 639.17.

The NPRM pointed out that this proposal is consistent with several recent initiatives, including the President's National Performance Review, Executive Order 12931 (Federal Procurement Reform), and the Federal Acquisition Streamlining Act of 1994 (FASA) (Pub. L. 103-355, 108 Stat. 3243 (October 13, 1994)), which direct Federal agencies to remove administrative burdens in procurement processes. They encourage and facilitate the procurement of commercially available items by exempting agencies from unnecessarily burdensome government-unique certifications and accounting requirements that add costs and discourage companies from doing business with them. Section 8203 of FASA, for instance, requires that agencies use uniform, simplified contracts for the procurement of commercial items and that they revise all procurement procedures not required by law to eliminate impediments to use of such contracts. In the NPRM, FTA stated that requiring its recipients to account separately for maintenance costs under a commercial lease is

unnecessarily burdensome and makes such leases more costly and cumbersome to administer. Recognizing these costs explicitly in section 639.17 should facilitate recipients' acquisition and maintenance of capital assets by allowing them to enter into standard commercial lease agreements more easily and at less cost.

The NPRM stated that this proposal is consistent with FTA's recently issued Circular 4220.1C ("Third Party Contracting Requirements," October 1, 1995"), which reduces FTA requirements; provides grantees increased flexibility in soliciting, awarding, and administering contracts; reduces FTA's role in third party procurement activity; and allows recipients to use their own procurement practices that reflect State or local laws, provided that they conform to applicable Federal law. FTA noted that neither section 308 of the STURAA nor the accompanying Senate Report indicates that maintenance costs should not be treated as eligible capital expenses.

In the NPRM, FTA sought comment on its proposal to recognize maintenance costs as eligible capital expenses under leasing agreements.

C. Comments on the NPRM

FTA received ten comments in response to the NPRM: six from public transit agencies, two from State departments of transportation, one from a metropolitan planning organization, and one from an association representing local mass transit systems.

All of the commenters strongly supported FTA's proposal to recognize maintenance costs as eligible capital expenses under leasing agreements. They pointed out that the proposed amendment would streamline the procurement process for transit managers and allow them to make contractual arrangements consistent with standard business practices. Two commenters opined that in the current climate of declining Federal operating assistance, the ability to charge maintenance costs as capital expenditures would somewhat ease the impact of these reductions. Overall, the commenters agreed that the amendment would be a positive step toward both increased flexibility in the use of grant funds and decreased administrative burdens on grantees.

One commenter asked whether the costs of maintaining shared elements of a communications network could be eligible capital expenses under the amendment. The commenter noted that the capital items mentioned in the NPRM were for the exclusive use of the

lessee, e.g., bus garages, computers, etc. Communications networks, on the other hand, include both shared elements and components that are used exclusively by the lessee. Both, however, are inseparable elements of the network, and maintenance of both is essential to its proper operation.

As the NPRM indicated, the proposed amendment is intended to allow all maintenance services included in the overall lease cost of a capital item to be treated as an eligible capital expense. Therefore, any maintenance services charged to a grantee's capital lease would be eligible, whether they are for shared-use or exclusive-use segments of a system. Moreover, sections 639.25 and 639.27 of the regulation provide that estimated lease costs must be reasonable based on conditions applicable to the recipient, and that recipients are to use maintenance costs as a criterion in comparing leasing with purchasing or constructing an asset. Therefore, recipients may enter into leases of communications networks only if their share of the costs of maintaining common elements is reasonable, and if the cost of leasing, including the maintenance services, is more advantageous than purchase or construction. To the extent that these criteria are met, the cost of maintaining common elements of a communications or other network under a lease agreement would be an eligible capital expense.

One commenter recommended extending the amendment to rural transit services using Federal funds under 49 U.S.C. 5311, since rural systems play an integral role in State transportation networks but lack adequate maintenance resources. As indicated above, under the OMB Circular A-87 requirements that were in effect at the time FTA's leasing regulation was initially promulgated, the portion of the lease cost representing imputed interest was ineligible for reimbursement unless expressly authorized by statute. Because section 308 of the STURAA applied specifically to the use of section 5307 funds, the leasing regulation covered only that program. However, in a recent revision of Circular A-87 (60 FR 26484, May 17, 1995), OMB changed its requirements to allow the reimbursement of interest payments under financing arrangements such as lease agreements. Therefore, specific statutory authorization is no longer required to permit capital reimbursement for the interest portion of any federally funded lease. Accordingly, 49 CFR Part 639 is now applicable to all FTA programs.

One commenter suggested that FTA allow all maintenance costs, including those that are not part of a lease agreement, to be treated as eligible capital expenses. The commenter stated that regular maintenance is necessary to ensure the availability and adequate functioning of all capital assets. Therefore, even in instances where maintenance expenses are paid separately by a recipient under either a lease or purchase arrangement, reimbursement at the capital rate should be allowed.

The commenter's suggestion goes far beyond the scope of this proposed amendment, whose purpose is to facilitate recipient's entry into standard commercial leases that include maintenance and repair costs as integral components. Moreover, as noted above, neither section 308 of the STURAA nor the accompanying Senate Report indicates that maintenance costs should not be treated as eligible capital expenses under a lease arrangement. FTA therefore believes that it has the statutory authority necessary to amend the regulation to allow the reimbursement as capital expenses of maintenance costs included in lease payments. However, FTA does not at the present time interpret its statutory authority to permit maintenance costs incurred outside of a lease agreement to be treated as capital expenses. In order to provide recipients with greater flexibility in their use of grant funds, FTA is considering seeking such authorization, and will amend its grant requirements accordingly at such time.

Another commenter noted that under its Capital Cost of Contracting Policy (FTA Circular 7010.1, December 5, 1986), FTA must approve all leases for vanpool vehicles when section 5307 funds represent more than 35 percent of the lease cost. The commenter proposed that this requirement be eliminated in the interest of streamlining the grant process and removing administrative burdens on acquisitions.

First, the Capital Cost of Contracting Policy should not be confused with capital leasing under 49 CFR 639. Under the Capital Cost of Contracting Policy, a recipient contracts with a private carrier to provide mass transit service. The percentage of the service representing "the capital consumed in the contract" may be paid for with capital funds. Under the capital leasing rule, recipients may acquire tangible assets by lease, and all eligible lease costs may be reimbursed as capital expenses. Second, FTA has used industry studies and other objective data to determine which percentage of the service under a Capital Cost of Contracting arrangement

should be eligible for capital reimbursement. Until it receives information justifying another percentage, it will not amend its Capital Cost of Contracting Policy, and reserves the right to review all contracts in which reimbursement with section 5307 capital funds exceeds that percentage.

Five commenters remarked that the language of section 639.17(b) as currently written contradicts the intent of the NPRM, since it could be construed to disqualify maintenance costs as eligible capital expenses. Section 639.17(b) now provides that "the costs of materials, supplies and services provided under the terms of the lease may not be eligible for capital assistance, if they would not be eligible for capital assistance under a traditional purchase or construction grant." Maintenance costs have not been eligible for capital assistance under a traditional purchase or construction grant, and section 639.17(b) could be interpreted to preclude their reimbursement at the capital level. The commenters requested clarification of section 639.17(b), and one recommended revised language for that section providing such clarification.

D. FTA'S Final Action

In keeping with the comments received, FTA will amend section 639.17(a) to recognize maintenance costs as eligible capital expenses under a lease agreement. FTA believes that this action removes a significant impediment to capital leasing, and provides flexibility that can foster further innovations in the use of Federal funds.

FTA is also revising section 639.17(b) to define eligibility for capital assistance in a manner that should not be construed to eliminate maintenance costs as an eligible capital expense.

II. Regulatory Impacts

A. Executive Order 12866

FTA has determined that this action is not significant under Executive Order 12866 or the regulatory policies and procedures of Department of Transportation regulatory policies and procedures. Since this final rule makes only a technical amendment to current regulatory language, it is anticipated that the economic impact of this rulemaking will be minimal; therefore, a full regulatory evaluation is not required.

B. Regulatory Flexibility Act

In accordance with 5 U.S.C. 603(a), as added by the Regulatory Flexibility Act, Pub. L. 96-354, FTA certifies that this rule will not have a significant impact on a substantial number of small entities within the meaning of the Act.

C. Paperwork Reduction Act

This action does not contain a collection of information requirement for purposes of the Paperwork Reduction Act of 1995.

D. Executive Order 12612

This action has been reviewed under Executive Order 12612 on Federalism and FTA has determined that it does not have implications for principles of federalism that warrant the preparation of a Federalism Assessment. If promulgated, this rule will not limit the policy making or administrative

discretion of the States, nor will it impose additional costs or burdens on the States, nor will it affect the States' abilities to discharge the traditional governmental functions or otherwise affect any aspect of State sovereignty.

III. List of Subjects in 49 CFR Part 639

Government contracts, Grant programs—Transportation, Mass transportation.

Accordingly, for the reasons described in the Preamble of this document, FTA is proposing to amend Title 49, Code of Federal Regulations, Part 639 as follows:

PART 639—[AMENDED]

1. The authority citation for Part 639 is revised to read as follows:

Authority: 49 U.S.C. 5307; 49 CFR 1.51.

2. Section 639.17 is revised to read as follows:

§ 639.17 Eligible lease costs.

(a) All costs directly attributable to making a capital asset available to the lessee are eligible for capital assistance, including, but not limited to—

- (1) Finance charges, including interest;
- (2) Ancillary costs such as delivery and installation charges; and
- (3) Maintenance costs.

(b) Any asset leased under this part must be eligible for capital assistance under a traditional purchase or construction grant.

Issued on: May 13, 1996.

Gordon J. Linton,

Administrator.

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