

Guidelines for Capital Project Grants to Political Subdivisions

A Report to the Minnesota Legislature

**Minnesota Department of Finance
November 15, 1994**



**State of Minnesota
Department of Finance**

RECEIVED

MAR 31 1995

LEGISLATIVE REFERENCE LIBRARY
STATE OFFICE BUILDING
ST. PAUL, MN 55155

400 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155
Voice: (612) 296-5900
TTY/TDD: (612) 297-5353 or
Greater Minnesota 800-627-3529
and ask for 296-5900
Fax: (612) 296-8685

November 15, 1994

The Honorable Irv Anderson
Speaker of the House
463 State Office Building
St. Paul, MN 55155

The Honorable Allan Spear
President of the Senate
G-27 State Capitol
St. Paul, MN 55155

Dear Speaker Anderson and President Spear:

The Department of Finance is pleased to submit **Guidelines for Capital Project Grants to Political Subdivisions**. This report is forwarded to the Legislature pursuant to requirements of Laws 1994, Chapter 643, Section 82.

The purpose of this report is to present guidelines for capital project grants to political subdivisions and non-profit organizations, and to recommend a more comprehensive process for the Legislature when considering competing capital projects.

Recommendations contained in this report are an extension of capital budget reform efforts enacted in the 1994 session. Major recommendations include the need to acquire better and more timely information on projects submitted by local jurisdictions, the need to evaluate such requests on their statewide significance, and the desire to minimize the state's financial involvement in projects of this type.

Further review and legislative action on these guidelines would be appropriate before preparation of the next major capital budget and bonding bill in 1996. I am available to address legislative committees on this report, as well as any other capital budget issue, and answer any questions you may have.

Sincerely,

Laura M. King
Commissioner

cc: Loren Solberg, Chair, House Ways and Means Committee
Henry Kalis, Chair, House Capital Investment Committee
Gene Merriam, Chair, Senate Finance Committee
Secretary of the Senate (1)
Chief Clerk of the House of Representatives (1)
Legislative Reference Library (6)

Table of Contents

Executive Summary	1
Recommended Guidelines	3
Capital Budget Policies of Other States	11
Use of General Obligation Bond Proceeds	15
Appendices	
Appendix A, Order of the Commissioner dated July 18, 1994	17

Executive Summary

Laws of 1994, Chapter 643, Section 82 (the 1994 bonding bill) requires a report by the commissioner of finance to the legislature with recommended guidelines for capital improvement projects that involve grants to political subdivisions. This report is presented to comply with the reporting requirement of the law.

The report includes three main sections. Chapter 1 presents recommended guidelines for capital project grants to political subdivisions. Chapter 2 reviews research requested by the law regarding how other states prioritize similar projects. The third and final chapter reviews the Order of the commissioner, adopted July 18, 1994, that describes under which circumstances political subdivisions may have capital facilities built or improved through the use of general obligation bonds.

Findings and Recommendations

The commissioner of finance finds that capital budget guidelines need to be adopted regarding projects that involve grants to political subdivisions in the acquisition and betterment of facilities to be used for various public purposes. In the interest of responsible public policy-making, the following guidelines are recommended:

- Political subdivisions should fund local projects to the fullest extent possible before requesting state assistance.
- If state funding is to be provided, the state share should be limited to no more than 50% of construction costs and the legislature should not fund any local project which requires new or additional state operating subsidies. Caution should be exercised when considering local projects that would expand the state's role in new policy areas or which would create inequities among jurisdictions.
- Requests should be submitted through the official capital budget process on required forms to provide adequate information and further a meaningful consideration of the project by the governor and legislature.
- The legislature should evaluate competing requests on the strategic value to the state of the project under consideration; the local, regional or statewide significance and dispersion of benefits of the project; and the percentage of local or user financing for the project.

- Finally, all requests and subsequent bonding appropriations must comply with constitutional provisions regarding definitions and eligible capital expenditures and the proper use of state bond proceeds.

Questions regarding any of these initiatives may be forwarded to the Department of Finance at 296-5900.

**Recommended Guidelines for
Capital Project Grants to
Political Subdivisions**

1994 Bonding Bill Reporting Requirement

Laws of 1994, Chapter 643, Section 82 (the 1994 bonding bill) requires the commissioner of finance to develop guidelines for capital improvement projects that involve grants to political subdivisions. The law requires guidelines to be set forth, research to be conducted in how other states prepare their capital budgets, and attention given to projects where facilities will be used by non-public organizations.

"The commissioner of finance shall develop budget guidelines for capital improvement projects that involve grants to political subdivisions to acquire and better facilities to be used for educational or cultural purposes. The commissioner shall give particular attention to projects where the facilities will be leased to or managed by a nonprofit organization. The commissioner shall review budget guidelines and processes used by other states to evaluate and prioritize projects of this kind. The commissioner shall consider for inclusion in the guidelines a method of measuring the fiscal capacity and fiscal effort of nonprofit organizations and the political subdivisions to whom the grants are proposed to be paid. The commissioner shall report proposed guidelines to the legislature by November 15, 1994".

This report, **Guidelines for Capital Project Grants to Political Subdivisions**, is the commissioner's response to the requirements of the law.

Action in the 1994 Legislative Session

In the 1994 session, the legislature and governor approved the most comprehensive and far-reaching bonding bill in the history of the state of Minnesota. The bonding bill and associated six-year strategic capital budget plan incorporated many major capital budget reforms.

The essence of capital budget reform is to achieve two basic goals:

1. to make informed capital investment decisions according to a fair, open and objective process, and
2. to effectively manage resulting assets.

Towards that end, the capital budget process that culminated in passage of the 1994 bonding bill included many important changes, such as:

- Development of a six-year strategic capital budget plan and six-year financing capabilities.
- Improved forms and instructions to encourage maximum information available to the legislature and governor.
- A formalized review of projects by the Department of Finance (DOF) and Administration (Admin) which included the scoring of requests for purposes of comparative evaluation.
- Introduction of the principle of a staged sequence of appropriations for predesign, design and construction activities.

With the development of a six-year planning horizon and favorable debt service capacities, the legislature was able to adopt and the governor approved a substantial capital budget and bonding bill in 1994. Significant projects spanning many state agencies were approved.

At the same time, the 1994 session witnessed numerous capital requests of political subdivisions and non-profit organizations from throughout the state. Examples of projects that were ultimately adopted include Metropolitan Council parks and open space grants, design of the Minnesota Science Museum, construction of the Children's Museum of Minnesota, American Indian Museum at Bemidji State University, design of the Prairieland Expo Center in Worthington, Hopkins Arts Center, various grants to environmental learning centers statewide and many others.

In some cases, the projects were directly associated with political subdivisions and the services they provide. Other projects originated from non-profit organizations that worked with political subdivisions to receive bonding funds, reflecting state constitutional provisions requiring bond proceeds to be used solely for public purposes and public facilities and assets.

Private parties and non-profit (non-public) organizations are not directly eligible to receive state general obligation bond proceeds. State general obligation bond proceeds may only be used for projects of this type if such proceeds are appropriated to political subdivisions. In this situation, political subdivisions must have a public program managed by a non-public organization in a facility funded by general obligation bond proceeds and owned by the political subdivision.

Due to the large number of such requests, legislators were rightfully concerned with the need to establish an orderly process to evaluate competing projects and ensure that public funds would be expended in a legal manner.

Because of this, the 1994 bonding bill was amended to require the commissioner of finance to prepare recommended guidelines for capital project grants to political subdivisions. These guidelines apply most specifically to political subdivisions that receive grants for public facilities to be operated and managed by private and non-profit (non-public) organizations.

In the interest of responsible public policy-making, to ensure that adequate information is available to elected officials in order to make informed decisions and to guarantee that public funds are being properly spent, the commissioner of finance recommends the following guidelines:

Recommended Guidelines for Capital Project Grants to Political Subdivisions

1. Political subdivisions should fund local projects to the fullest extent possible before requesting state assistance.
2. All requests and subsequent bonding appropriations must comply with constitutional provisions regarding definitions of eligible capital projects and the proper use of state bond proceeds.
3. Requests must be submitted with adequate information to allow a meaningful consideration of the project by the governor and legislature. The preferred approach is to have each request go through the governor's capital budget process. At a minimum, each project should be presented to the legislature on official capital budget forms provided by the Department of Finance. This includes a full description of project costs and benefits, future funding requirements, and associated operating budget implications. The legislature should not accept project requests from any source that are not prepared in this manner.
4. Whenever possible, requests by political subdivisions should be included in submittal packages of state agencies in cases where a logical policy linkage exists. In cases where a link does not exist between a local project and any state agency, the request should be submitted directly to the Department of Finance.

5. Competing projects should be selected on criteria including:
 - the strategic value to the state of the project under consideration;
 - the statewide significance of the project (e.g., whether the project has local, regional, or statewide significance); and
 - the percentage of local and user financing brought to the project.
6. Grants to political subdivisions should be funded in a staged sequence of predesign, design and construction appropriations. Design appropriations should not be awarded before predesign plans are completed and submitted to the governor and legislature for consideration. Construction appropriations should not be awarded before the predesign and design stages are satisfactorily completed. Predesign and design activities must comply with the provisions of Minnesota Statutes 16B.335, subdivisions 1-5, regarding preparation of predesign and design documents and their subsequent review by the Department of Administration and the chairs of the Senate Finance committee and House Ways and Means committee.
7. It is recommended that the state should not fund predesign and design activities for projects of political subdivisions at an amount greater than 20% of such costs and should not fund more than 50% of construction costs. Furthermore, the legislature should not fund any capital grant to a political subdivision which would require new or additional state operating budget subsidies to that political subdivision or any non-public organization. Caution should also be used when considering local projects which would expand the state's role in new policy areas or which would cause inequities among jurisdictions.
8. All capital projects that are financed with state bond proceeds must comply with the provisions of Minnesota Statutes 16A.695 regarding the proper lease, management and sale of state bond-financed property. This applies directly to publicly-owned property which is leased to or operated by non-public organizations.
9. The legislature, through action in the Senate Finance and House Capital Investment committees, should review these recommendations and adopt a formalized set of committee policies addressing these issues prior to consideration of the 1996 bonding bill.

Each of these nine recommendations is described more completely, as follows:

Recommendation #1: Political subdivisions should fund local projects to the fullest extent possible before requesting state assistance.

In this era of limited public financial resources, political subdivisions and non-public organizations must accept the fact that the state cannot fund all requests. This is not meant to diminish the value of the projects under consideration. It is a reminder, however, of the principle that each level of government bears responsibility for providing certain primary services to the public. The state cannot, nor should not, assume responsibility for funding local projects or services. Similarly, the private sector and non-profit organizations must assist in filling voids where government services cannot be provided.

There are also equity considerations involved. If the state begins funding local projects in some areas, an avalanche of similar requests from other jurisdictions becomes largely unavoidable.

Recommendation #2: All requests and subsequent bonding appropriations must comply with constitutional provisions regarding definitions of eligible capital projects and the proper use of state bond proceeds.

The Constitution of the state of Minnesota sets parameters regarding what types of debt the state may incur and for which purposes debt may be used. This applies specifically to the use of proceeds from the sale of state general obligation bonds. These issues are discussed in depth in the third chapter and Appendix A of this report. In sum, applicants should be aware that state bond proceeds can only be used for capital projects which meet a public purpose and for public facilities owned by public entities. The Constitution does not allow public debt to be incurred for private purposes.

Recommendation #3: Requests must be submitted with adequate information to allow a meaningful consideration of the project by the governor and legislature. The preferred approach is to have each request go through the governor's capital budget process. At minimum, each project should be presented to the legislature on official capital budget forms as prescribed by the Department of Finance. This includes a full description of project costs and benefits, future funding requirements, and associated operating budget implications. The legislature should not accept project requests from any source that are not prepared in this manner.

One of the major difficulties in evaluating local requests in the last session was a general lack of uniform and comprehensive information available to decision-makers. Unlike capital requests from state agencies which were required to go through the formal capital budget process, projects from political subdivisions and non-public organizations were often presented with inadequate written information on project rationale, costs, cash flows, future funding requirements and operating budget implications.

The governor, the departments of Finance and Administration, and many legislators believed that the lack of information available for these projects was largely unacceptable. It is desirable for the legislative and executive branches to join together to require better information from these jurisdictions for projects of this type in the future. Without the availability of adequate and widely-disseminated information on these projects, appropriations for these requests cannot meet the test of informed investments or prudent financial management.

Recommendation #4: Whenever possible, requests by political subdivisions should be included in submittal packages of state agencies in cases where a logical policy linkage exists. In cases where a link does not exist between a local project and any state agency, the request should be submitted directly to the Department of Finance.

Examples of local requests which have been included in the past in agency capital budget submittal packages include Metropolitan Council parks and open space requests forwarded by the Department of Natural Resources, and local economic development projects forwarded by the Department of Trade and Economic Development. In other cases, local projects might not neatly fit into agency packages and should be submitted directly to DOF, which will then forward such requests directly to the governor and legislature.

Recommendation #5: Projects should be selected on criteria including:

- the strategic value to the state of the project under consideration;
- the statewide significance of the project (e.g., whether the project has local, regional, or statewide significance); and
- the percentage of local and user financing brought to the project.

Projects will be evaluated by DOF in relation to the criteria listed above which will be incorporated into the scoring system of the upcoming capital budget cycle. As such, grants to political subdivisions will be scored in the same manner as other capital budget requests.

Legislators are urged to look at the results of the scoring system and consider the same criteria when deciding among competing projects.

Recommendation #6: Grants to political subdivisions should be funded in a staged sequence of predesign, design and construction appropriations. Design appropriations should not be awarded before predesign plans are completed and submitted to the governor and legislature for consideration. Construction appropriations should not be awarded before the predesign and design stages are satisfactorily completed. Predesign and design activities must comply with the provisions of Minnesota Statutes 16B.335, subdivisions 1-5, regarding preparation of predesign and design documents and their subsequent review by the Department of Administration and the chairs of the Senate Finance committee and House Ways and Means committee.

The concept of a sequential series of predesign, design and construction appropriations was first introduced last session. The idea is to spend a little for predesign (usually less than 1/2 of 1% of total project costs), before spending more for design (typically 5-7% of project costs), before spending a considerable sum for construction (usually greater than 90% of total project costs). By minimizing an investment in the front-end of a project through this leveraging technique, decision-makers receive substantial information early in the life of a project before committing substantial resources.

The Department of Administration is in the process of drafting predesign requirements that will be forwarded to agencies and interested parties very soon. The information that is submitted by recipients in response to these requirements and forwarded to the legislature and governor as a predesign document should contain a comprehensive view of the project's rationale, use components, costs, schedule, cash flows and operating cost implications. Aided by this predesign information early in the process, the legislature and governor will have better information at a minimal cost in which to evaluate the project and decide whether subsequent design and construction appropriations are warranted.

Recommendation #7: It is recommended that the state should not fund predesign and design activities for projects of political subdivisions at an amount greater than 20% of such costs and should not fund more than 50% of construction costs. Furthermore, the legislature should not fund any capital grant to a political subdivision which would require new or additional state operating budget subsidies to that political subdivision or any non-public organization. Caution should also be used when considering local projects which would expand the state's role in new policy areas or which would cause inequities among jurisdictions.

The purpose of this recommendation is to leverage a reasonable amount of non-state resources towards project costs. Recognizing that grants awarded to political subdivisions are for projects which are not primarily the obligation of state government, it would be prudent to expect that such entities take responsibility for raising the majority of project costs. If local organizations are unable to successfully raise funds to contribute towards the project, a lack of local support is clearly self-evident. By reducing the state share of funds contributed to any one project, available resources can be spread across a larger number of recipients.

The idea of cost sharing is not a new concept to state government or capital budgeting. A major precedent currently exists in the bonding bill which requires the higher education systems to pay 1/3 of their debt service. Similarly, the DOF scoring system allocates additional points to capital requests based on the percentage of the project's user and non-state financing. Many capital projects were approved in 1994 at least in part because significant non-state resources were involved.

Recommendation #8: All capital projects that are financed with state bond proceeds must comply with the provisions of Minnesota Statutes 16A.695 regarding the proper lease, management and sale of state bond-financed property. This applies directly to publicly-owned property which is leased to or operated by non-public organizations.

Recommendation #9: The legislature, through action in the Senate Finance and House Capital Investment committees, should review these recommendations and adopt a formalized set of committee policies addressing these issues prior to consideration of the 1996 bonding bill.

It would be prudent for legislative committees with primary responsibility for considering capital budget items to review these recommendations and adopt a formalized set of committee policies for dissemination to all interested parties. With the next major capital budget scheduled for consideration in 1996 and with the 1995 legislative session thus anticipating only minimal capital budget issues, action on these or similar recommendations should be thoughtfully pursued in 1995. Dissemination of such policies in a timely manner would allow for informed planning at the local level and better information available to the governor and legislature in the 1996 session.

Capital Budget Policies of Other States

Section 82 of the 1994 bonding bill asks the commissioner of finance to review budget guidelines and processes used by other states to evaluate and prioritize projects of political subdivisions, particularly in cases where the project will be leased to or operated by a non-profit organization. This chapter describes the results of research conducted in this area.

The Department of Finance has on numerous occasions surveyed other states as to how they review capital budget requests and prepare their state capital budgets. The results of these discussions as well as research conducted specifically for this report point to the conclusion that most other states do not generally have capital budget processes that are as highly articulated as their operating budget process, nor is their capital budgeting as advanced as many capital budget reforms currently underway in the state of Minnesota.

It is difficult to find credible or largely relevant information on capital budgeting of other states. Many states do not have a clearly-defined, written capital budget process. These states often include capital budgeting as one of many elements in their operating budgets and provide capital funds within operating budget appropriations. Other states prepare capital budgets that contain only minimal project information. Nine states have constitutional prohibitions against issuing general obligation debt and therefore undertake minimal state capital budgets, with practically no assistance for local projects.

Table 1
States with No General Obligation Debt

Arizona	Kansas
Idaho	Nebraska
Iowa	South Dakota
Indiana	Wyoming

Source: Moody's Investors Service, Inc.; *Perspective on State Credit Analysis*; July 21, 1993.

To compound matters, staff has been unable to locate any single clearinghouse of state capital budget information. Even reliable national organizations which typically provide meaningful budget data such as the National Association of State Budget Officers (NASBO) has scant information available in this area. Bond rating firms such as Fitch Investors Services were contacted, but compile information primarily on bond sales and state-by-state financial data rather than processes used by states to select among competing capital projects.

In absence of easily-obtainable information, Finance staff directly contacted each of Minnesota's border states (Iowa, South Dakota, North Dakota, and Wisconsin) as well as states outside the midwest to evaluate their current methods of capital budgeting. The most relevant example of a state capital budget containing a highly-articulated policy for funding projects of political subdivisions is New Mexico, which is described later in this chapter.

The main conclusion to be drawn from this research is that most states fund local capital projects at a minimal level, if at all. The states that do provide capital assistance to political subdivisions do so primarily in the areas of public education, housing, and pollution control systems -- projects which contain statewide policy interests.

We were unable to locate any states, including our border states, that use general obligation bonding for cultural facilities such as community centers or civic centers. States such as Connecticut, Illinois and Louisiana have provided assistance in financing major convention and entertainment facilities but have done so with revenue bonds backed by hotel/motel/entertainment and other sales taxes, rather than general obligation bonds. It is safe to conclude that states generally avoid using general obligation bonds for local cultural or recreational facilities.

This report does not address more generalized state/local funding issues related to K-12 education or higher education.

New Mexico Local Infrastructure Capital Improvements Plans

The state of New Mexico encourages local governments to develop Local Infrastructure Capital Improvement Plans (ICIPs) as a step towards initiating rational, long-range capital planning for local infrastructure in New Mexico. The New Mexico Department of Finance and Administration and the State Council of Governments assist local governments in developing ICIPs and work with state agencies to link local and state projects whenever feasible.

The five year plans are developed by political subdivisions including municipalities and counties as a means of conducting strategic planning and identifying and prioritizing local capital projects. ICIPs are often linked with local comprehensive land-use plans. Based on a review of these plans and the priorities contained within the ICIPs, the state may provide assistance through a variety of financing mechanisms to local governments.

New Mexico's capital policies differentiate between state obligations and local programs, however. For example, the state traditionally has retained responsibility for highways, state government buildings and equipment, higher education facilities, housing, state parks, and fish and game projects. In addition to these direct state programs, the Legislative Capital Outlay Committee has provided assistance to local governments in environmental protection, public school construction, economic development and water rights/water supply issues.

Local governments have direct responsibility for capital programs involving municipal and county roads and bridges, storm and sanitary wastewater systems, general municipal buildings and equipment, airports, transit, parks and recreation, *and cultural facilities*.

A copy of the New Mexico process and related documents is available for public review at the offices of the Minnesota Department of Finance.

Iowa

The state of Iowa does not use general obligation bonds for financing any project. When capital financing for state projects is required, the state utilizes revenue bonds or direct cash appropriations. Due to these limitations, the state has a minimally-sized capital budget and does not bond for any local project (i.e., county, school district or municipal projects).

South Dakota

The state of South Dakota does not prepare a formal capital budget and is prohibited by its constitution from issuing general obligation bonds. For capital projects that are funded, the state prefers to finance from current revenues and includes funding for such projects in various appropriation bills.

The state utilizes revenue bonding from three authorities for capital projects: the South Dakota Housing Authority, Building Authority, and Health & Education Facilities Authority. The only such bonding for local projects from these three authorities are for purposes of housing, hospitals and school districts.

From general fund appropriations, political subdivisions receive funding for construction of water facilities in the form of grants, loans and the state share of proceeds from Lotto sales.

North Dakota

The state of North Dakota does not use bond proceeds for local projects of political subdivisions and non-profit organizations. Bonding is used for state projects only.

North Dakota is currently exploring the concept of establishing an entity to serve as a "municipal bond bank." This state entity would sell bonds for local projects at favorable terms and lend the proceeds to local governments who would be responsible for debt service payments and other costs of participation. The state has not formally endorsed this idea, however.

Wisconsin

Wisconsin prepares a biennial capital budget which includes bonding for state projects only. Wisconsin does not use state general obligation bonds for local projects.

Use of General Obligation Bond Proceeds

In increasing numbers over the last several years, private and non-profit (non-public) organizations have been seeking appropriations from general obligation bond proceeds for construction or remodeling of capital facilities. The Minnesota Constitution does not allow for general obligation bond proceeds to be appropriated directly to non-public organizations. The Constitution states that "Public debt may be contracted and works of internal improvement carried on for the following purposes...", which include, "to acquire and to better public lands and buildings and other public improvements of a capital nature and to provide money to be appropriated or loaned to any agency or political subdivision of the state for such purposes...".

The Department of Finance recognized the need to better communicate the circumstances under which non-public organizations could have capital facilities built or improved through the use of general obligation bond proceeds. During the 1994 legislative session, the Department of Finance drafted guidelines on the use of bond proceeds by non-public organizations with the intent of distributing these guidelines. The 1994 legislature incorporated these guidelines into a new law (Minnesota Statutes 16A.695), thus establishing requirements for the use of state general obligation bond proceeds by non-public organizations. The legislation also established requirements related to the sale of property financed by state general obligation bond proceeds.

The legislation required the commissioner of finance to establish an Order relating to the use and sale of state bond financed property. That Order was executed on July 14, 1994 and is included as Appendix A of this report.

Private parties and non-public organizations are not directly eligible to receive state general obligation bond proceeds. State general obligation bond proceeds may only be used for projects of this type if such proceeds are appropriated to political subdivisions. In this situation, political subdivisions must have a public program managed by a non-public organization in a facility funded by general obligation bond proceeds and owned by the political subdivision.

State agencies and political subdivisions that receive appropriations of general obligation bond proceeds to be utilized by non-public organizations or expect to sell property that was financed in whole or in part by general obligation bond proceeds should review the Order in its entirety and consult with their legal advisors.

Political subdivisions and non-public organizations should review the commissioner's Order to understand the requirements that they will have to follow when seeking bond financing for their capital improvements and the requirements related to sale of the bond-financed property in the future.

The main points contained in the commissioner's Order include the following:

- State general obligation bonds can be issued only to finance publicly-owned land, buildings or improvements to be used to conduct governmental programs of the state and its political subdivisions.
- "State bond financed property" means property acquired or bettered in whole or in part with the proceeds of state general obligation bonds.
- A use contract between a public agency and a non-public party can be entered into only for the express purpose of carrying out a governmental program established by law and authorized by official action of the contracting public officer or agency.
- The use contract must provide for on-going program oversight by a public officer or agency, which includes the right of termination, and must be approved by the commissioner of finance.
- Certain requirements apply to the sale of state bond-financed property and associated reimbursements to the state of Minnesota.

Please note that the above information is only a brief and summarized version of the commissioner's Order. All interested parties are strongly encouraged to read the complete Order as contained in Appendix A to obtain a full understanding of all applicable requirements.

Questions regarding the commissioner's Order may be forwarded to Peter Sausen, Assistant Commissioner for Cash and Debt Management at (612) 296-8372.

Appendix A: Commissioner's Order

Appendix A is an Order of the commissioner of finance regarding the use of state general obligation bond proceeds by private and non-profit organizations and the sale of property financed from the proceeds of state general obligation bonds. This Order was prepared pursuant to Laws of 1994, Chapter 643, Subdivision 2(b).



**State of Minnesota
Department of Finance**

400 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155
Voice: (612) 296-5900
TTY/TDD: (612) 297-5353 or
Greater Minnesota 800-627-3529
and ask for 296-5900
Fax: (612) 296-8685

July 18, 1994

To: Interested Parties

Fr: John Gunyou *JK*
Commissioner

Re: Commissioner's Order and the Submission of Required Reports

The 1994 Legislature included in the bonding bill (Laws of 1994, Chapter 643) a new provision to state law (16A.695) regarding the use of state general obligation bond proceeds by private and non-profit organizations and the sale of property financed from the proceeds of state general obligation bonds.

I have adopted an order as required in Chapter 643, Section 36, Subdivision 2 (b) for the purpose of establishing requirements to be complied with by public officers and agencies in entering into contracts relating to the use or sale of state bond financed property. State agencies that enter into contracts for capital projects financed by general obligation bonds to be used by private or non-profit organizations or for the sale of state bond financed property should carefully review the attached Order.

Chapter 643, Section 37 requires two reports. Subdivision 1 requires a report on leases or management contracts. The language requires a public officer or agency that has entered into a lease or management contract with respect to state bond financed property on or after January 1, 1989, and before the effective date of the act (May 17, 1994), to file a report with the Commissioner stating the purpose of the lease or contract, the name and nature of the lessee or contracting party, the terms of the lease or contract, and the use or disposition of any money received by the public officer or agency under the lease or contract.

Subdivision 2 requires a public officer that has sold state bond financed property on or after January 1, 1989, and before the effective date of this act, to file a report with the Commissioner stating the reason for sale, the method of sale, the purchaser, the sale price, and the use or disposition of the net sale proceeds.

If your agency has entered into a lease or management contract as stated in Subdivision 1 and/or has sold land as stated in Subdivision 2, please submit the information required to the Department of Finance by September 2, 1994.

Questions regarding the Commissioner's Order or the information required in the two reports should be directed to Peter Sausen, Assistant Commissioner, at 296-8372.

ORDER OF COMMISSIONER OF FINANCE
RELATING TO USE AND SALE OF STATE
BOND FINANCED PROPERTY

IT IS HEREBY ORDERED by the Commissioner of Finance of the State of Minnesota:

Section 1. Authorization; Purpose; Necessity.

1.01. Authorization. This Order is adopted pursuant to Minnesota Laws 1994, Chapter 643, Section 36, for the purpose of establishing requirements to be complied with by public officers and agencies in entering into contracts relating to the use or sale of state bond financed property.

1.02. Purpose. The purpose of the requirements is to ensure that the proceeds of state general obligation bonds authorized by the legislature to be issued to finance the acquisition or betterment of public land and buildings and other improvements of a capital nature by the state and its political subdivisions are used for such purposes, and that the interest to be paid thereon is and will continue to be (whenever possible) exempt from federal income taxation. Essentially, state general obligation bonds can be issued only to finance publicly owned land, buildings or improvements to be used to conduct governmental programs of the state and its instrumentalities and political subdivisions. Where state bonds are to be issued to finance property which is to be leased, managed, operated or otherwise used by a non-public party, or where state bond financed property is to be sold to a non-public party, questions may arise as to the legality and tax-exempt status of the bonds. Accordingly, the requirements set forth herein are to be complied with by a public officer or agency in entering into lease, management or other similar contracts relating to the use of state bond financed property pursuant to state law, and in selling state bond financed property, to ensure the legality and tax-exempt status of the bonds.

1.03. Necessity. The provisions of this Order are determined to be necessary to ensure the legality and tax-exempt status of state general obligation bonds and compliance with the act.

Section 2. Definitions. For purposes of this Order the terms defined in this Section shall have the meanings given to them in this Section.

2.01. Act. "Act" means Minnesota Laws 1994, Chapter 643, Section 36, which became effective on May 17, 1994.

2.02. Code. "Code" means the Internal Revenue Code of 1986, as amended from time to time, and all treasury regulations, revenue procedures and revenue rulings issued pursuant thereto.

2.03. Commissioner. "Commissioner" means the Commissioner of Finance or his or her designated representative.

2.04. Fair Market Value. "Fair market value" means, with respect to the sale of state bond financed property, the price that would be paid by a willing and qualified buyer to a willing and qualified seller as determined by an appraisal of the property, or the price bid by a purchaser under a public bid procedure after reasonable public notice.

2.05. Non-Public Party. "Non-public party" means a person or entity other than a public officer or agency.

2.06. Public Officer or Agency. "Public officer or agency" means a state officer or agency, the University of Minnesota, the Minnesota Historical Society, and any county, home rule charter or statutory city, school district, special purpose district, or other public entity, or any officer or employee thereof. It does not include the United States or any agency or instrumentality of the United States.

2.07. State Bond Financed Property. "State bond financed property" means property acquired or bettered in whole or in part with the proceeds of state general obligation bonds. "Acquired" and "bettered" shall have the meanings given the terms "acquisition" and "betterment", respectively, in Minnesota Statutes, Section 475.51, and shall include planning and design activities related to a specific project.

2.08. State General Obligation Bonds. "State general obligation bonds" and "state bonds" mean state general obligation bonds authorized to be issued under Article XI, Section 5, clause (a) of the Minnesota Constitution, or any bonds issued to refund those bonds.

2.09. Use Contract. "Use contract" means a lease, management contract or other similar contract relating to state bond financed property, between a public officer or agency which owns or has jurisdiction over the property and another public officer or agency or a non-public party.

Section 3. Application. This Order shall apply only as provided in this Section, and the provisions of Sections 4 through 6 are subject to the provisions of this Section.

3.01. In General. This Order applies to transactions involving state bond financed property, regardless of when acquired or improved, unless otherwise provided by law, or unless such application would impair the obligations of a public officer or agency to a non-public party under a contract entered into pursuant to law, which contract was in effect on May 17, 1994. The commissioner will, from time to

time, issue, revise and publish a list of transactions exempted from the provisions of the act and this Order pursuant to law.

3.02. Certain Use Contracts. If the public officer or agency having jurisdiction over or which owns state bond financed property determines that it is permanently or currently not needed for governmental purposes, and the determination is approved by the commissioner, the requirements set forth herein relating to governmental programs shall not be applicable to use contracts relating thereto.

3.03. Transactions Between Public Officers and Agencies. This Order applies to transactions between and involving only public officers or agencies which are entered into pursuant to state law, except as specifically provided in Sections 4 and 5.

Section 4. Requirements for Use Contracts.

4.01. Statutory Authorization. (a) Use contracts relating to state bond financed property can be entered into only where authorized by state law other than the act; the act itself does not authorize, but only regulates, such contracts.

(b) A use contract must comply with the substantive and procedural provisions of the state law authorizing it, the act, and the requirements of this Order.

4.02. Requirements for Non-Public Party Use Contracts. Use contracts between a public officer or agency and a non-public party are governed by the provisions of Section 4.01 and this Section.

(a) The use contract must be entered into for the express purpose of carrying out a governmental program established by law or authorized by law and established by official action of the contracting public officer or agency. The governmental program and its purpose must be set forth in the use contract.

(b) The term of a use contract relating solely to land shall be governed by the state law authorizing it. The term of a use contract relating to buildings and improvements, including all renewal terms that are solely at the option of the non-public party, shall be substantially less than the useful life of the buildings or improvements. Ordinarily a use contract term not exceeding 50% of the useful life of the property to which it relates will be considered to be for a period substantially less than the useful life of such property. A use contract may allow renewal beyond the end of the original (or any previous renewal) term, upon determination by the public officer or agency by official action that such renewal is necessary or desirable to continue to carry out a governmental program.

(c) The use contract must provide for program oversight by a public officer or agency. A use contract which requires the non-public party to provide to the contracting public officer or agency an initial program implementation plan and, at least annually, a program evaluation report and a program budget showing program revenues and expenses, will be considered to provide for program oversight by a public officer or agency.

(d) The use contract must allow for termination by a public officer or agency in the event of default by the non-public party, or in the event the governmental program is terminated or changed, and may provide for notice of default for a specified period which is reasonable under the circumstances prior to termination.

(e) The use contract must require the non-public party to pay all costs of operation and maintenance of the state bond financed property allocable to it, unless the public officer or agency is authorized and agrees to pay such costs pursuant to state law. A use contract need not require the non-public party to pay to the public officer or agency any compensation for use of the state bond financed property unless required by a state law other than the act or required by the commissioner.

(f) If during any year of the term of a use contract relating to state bond financed property, state general obligation bonds issued to acquire or better such property are outstanding, a percentage of all moneys received by a public officer or agency pursuant to the use contract in excess of the amount needed and authorized to be used to pay operating costs of the state bond financed property must be paid to the commissioner by the public officer or agency and used by the commissioner to pay and redeem or defease state bonds issued to finance the property. Such percentage shall be determined by the commissioner and, absent circumstances which would indicate a different method, will be determined by dividing the total principal amount of all state bonds issued with respect to the state bond financed property by the total principal amount of all capital costs incurred with respect to such property by any public officer or agency or non-public party (including those payable from state bonds), without regard to the amount of bonds outstanding at any time.

4.03. Requirements for Public Officer or Agency Use Contracts. Use contracts between two public officers or agencies are governed by the provisions of Section 4.01 and this Section. The provisions of Section 4.02, paragraphs (a), (c), (d) and (f) shall apply to such use contracts.

4.04. Approval by Commissioner. (a) No public officer or agency shall enter into a use contract with respect to state bond financed property, or the renewal

or amendment of an existing use contract, without the prior written approval of the commissioner.

(b) Proposed use contracts, renewals and amendments and, with respect to use contracts involving a non-public party the related information described below, should be submitted to the commissioner not less than 60 days before their proposed date of execution, except that in the case of a use contract described in Section 4.05, paragraph (a), the use contract should be submitted not less than 90 days before such date, and the submission should indicate that Section 4.05 is applicable. Such related information should include, if not evident from the use contract, state law authorization; the name, address, nature, financial condition, and reason for selection of the non-public party; the initial or current program implementation plan and budget (except in cases of leases of excess property); and other information deemed relevant by the public officer or agency. The department of finance will endeavor to provide approvals or comments requiring change in use contract terms within a reasonable period after receipt of the proposed use contract and the related information, but failure to approve or provide comments on a proposed use contract shall not constitute approval.

4.05. Tax Considerations. (a) Except as provided in paragraph (b), if under the terms of a proposed use contract the commissioner reasonably expects to receive money pursuant to Section 4.02, paragraph (f), the public officer or agency shall, upon direction by the commissioner, take, and/or require the contracting non-public party to take, such actions and furnish such documents to the commissioner as the commissioner determines to be necessary to ensure that the interest to be paid on the state bonds issued to finance the property to which the use contract relates is exempt from federal income taxation. Such actions may include either (i) compliance with procedures intended to classify the state bonds as a "qualified bond" within the meaning of Section 141(e) of the Code, or (ii) changing the nature and/or terms of the use contract so that it complies with Revenue Procedure 93-19; or (iii) compliance with Code provisions, regulations, or revenue procedures which amend or supersede the foregoing.

(b) The commissioner may determine that under the Code the state bonds will not be subject to federal income taxation without regard to compliance with paragraph (a), or that compliance with the requirements of paragraph (a) is not practical or economically feasible, in which event compliance with paragraph (a) may not be required. In most cases, and barring special circumstances, compliance will not be required where the total amount of state bonds authorized by law to be issued with respect to a governmental project or program is less than \$1,000,000.

Section 5. Guidelines and Procedures for Sale of Bond Financed Property.

5.01. Authorization of Sales. (a) State bond financed property can be sold or transferred to a non-public party or a public officer or agency only where authorized by state law; the act itself does not authorize, but only regulates, such transactions.

(b) A sale or transfer must comply with substantive and procedural provisions of the state law authorizing it, the act, and the requirements of this Order.

5.02. Requirements for Sales. (a) Except as provided in paragraph (c), no public officer or agency shall sell state bond financed property unless the public officer or agency determines by official action that the property is no longer useable or needed to carry out the governmental program for which it was acquired or constructed, the sale is made for fair market value, and the sale is approved by the commissioner.

(b)(i) If any state bond financed property which is sold was acquired or improved solely with state bond proceeds, so much of the net proceeds of sale as is necessary to pay and redeem or defease the outstanding state bonds must be paid to the commissioner, deposited in the state bond fund, and used for this purpose, and any balance of the net proceeds shall be deposited in the general fund or other state fund designated by law; and (ii) if the state bond financed property which is sold was acquired or improved partly with state bond proceeds and partly with other money, the net proceeds of sale shall be paid to the commissioner and so much thereof as is necessary to pay and redeem or defease the outstanding state bonds shall be deposited in the state bond fund and used for this purpose, and any net sale proceeds not needed for this purpose shall be divided between or among and paid to the interested public and private parties which provided money for such acquisition or betterment, in proportion to the amounts of money provided by them for such purpose, which division shall be agreed to in writing between or among all of them.

(c) State bond financed property may be transferred between public officers or agencies for a nominal consideration where authorized by state law, if the transferor public officer or agency determines by official action that the state bond financed property to be transferred is no longer useable or needed to carry out the governmental program for which it was acquired or constructed, and the transferee public officer or agency determines by official action that the property is needed or useful for a governmental program of the transferee, the official action is filed with the commissioner, and the transferee public officer or agency acknowledges that any sale of the property by the transferee is subject to the provisions of this Order.

(d) Paragraphs (a) through (c) do not apply to transfers of control of state-owned property between state departments or agencies which are regulated by Minnesota Statutes, Section 15.16. So much of the moneys transferred to a state department or agency as a result of the transfer of control of state bond financed property as is necessary to pay and redeem or defease outstanding state bonds issued to finance the acquisition or improvement of the property, shall be transferred to the state bond fund and used for this purpose.

5.03. Approval by Commissioner. (a) No public officer or agency shall enter into a contract for the sale of state bond financed property or any amendment thereto affecting the sale price without the approval of the commissioner.

(b) Proposed sale contracts and amendments, and the related information described below, should be submitted to the commissioner not less than 60 days before their planned date of execution. Such related information should include, if not evident from the sale contract, state law authorization; the name, address and nature of the purchaser, if known; the proposed method of sale; the sales price and how it was determined; any appraisal upon which the sale price is based; and other information deemed relevant by the public officer or agency. The department of finance will endeavor to provide approvals or comments requiring change within a reasonable period after receipt of the proposed sale contract and the related information, but failure to approve or provide comments on a proposed sale contract shall not constitute approval.

Section 6. Grant and Loan Agreements; Title Records.

6.01. Grant and Loan Agreements. Every state officer or agency to which proceeds of state general obligation bonds are appropriated to fund a grant or loan to another public officer or agency shall enter into a grant or loan agreement with respect to such proceeds whereby the public officer or agency receiving the grant or loan acknowledges that use agreements relating to and sales of property acquired in whole or in part with the state bond proceeds: (a) are subject to the provisions of the act and this Order, and (b) will be used in a manner which will not cause the interest on the state bonds to be or become subject to federal income taxation, due to their classification as "private activity bonds" within the meaning of Section 141 of the Code, or as "arbitrage bonds" within the meaning of Section 148 of the Code, or for any other reason.

6.02. Title Records. Every public officer or agency which expends state general obligation bond proceeds to acquire or improve real property shall, not later than thirty (30) days after the first such expenditure or as soon thereafter as practical, cause to be recorded in the official real estate title records maintained by the county recorder for the county or counties in which the property is located, a declaration or other appropriate instrument in the form or substantially the same form attached

hereto as Exhibit 1. Upon full compliance with the provisions of this order and when appropriate, upon request, the Commissioner of Finance shall execute and deliver to the party requesting it, a written release evidencing the release of the subject property from the provisions of the act and this Order.


Section 7. Amendments; Publication; Effective Date.

7.01. Amendments. The Commissioner retains the right to amend this Order at any time as necessary to accomplish the purposes of the act.

7.02. Publication. The Commissioner intends to publish this Order and any amendments thereto in such manner and at such times as are likely to provide access to its contents by all affected persons, but the Order or any amendment shall be effective upon its issuance without regard to its publication.

7.03. Effective Date. This Order is effective as of its date of execution set forth below.

Executed on 14, 1994.



John Gunyou,
Commissioner of Finance

DECLARATION

The Property is bond financed property within the meaning of Minnesota Laws 1994, Chapter 643, Section 36, and cannot be sold, mortgaged or otherwise disposed of by the public officer or agency which has jurisdiction over it or owns it without the approval of the Minnesota Commissioner of Finance, which approval must be evidenced by a written statement signed by the Commissioner of Finance and attached to the deed, mortgage or instrument used to sell, mortgage or otherwise dispose of the Property.

Dated: _____

The foregoing instrument was acknowledged before me this ____ day of _____, _____, by _____, the _____ of _____, a _____ under the laws of _____, on behalf of the _____.

This Instrument Was Drafted By:
