



Date: May 1, 2008

To: Commissioners and Agency Heads
Agency Accounting Coordinators

From: Tom Hanson, Commissioner *TJH*

Subject: “After the Bonding Bill” – The Next Steps

This memo gives an overview of key constitutional, statutory and other legal requirements regarding how state agency recipients of state capital appropriations may spend the bonding bill appropriations.

This memo is not an exhaustive reference to all requirements. It summarizes the most noteworthy items, and identifies resources for additional information. Agencies should consult with their appropriate financial and legal advisors regarding these and other requirements.

This memo describes requirements associated with:

- 1) Public ownership, public purpose, and use agreements for state-funded projects
- 2) Standard state grant agreements
- 3) Non-state matching requirements for specific projects
- 4) Reimbursing local governments
- 5) Review of grant recipient’s operating program
- 6) Sustainable building guidelines for new buildings; Alternative energy sources
- 7) Predesign review by the Department of Administration
- 8) Design review by legislative committee chairs
- 9) One percent for art
- 10) Project cancellations
- 11) Reporting of asset preservation expenditures

The memo also references MAPS operating policies and procedures that apply to capital appropriations. The Department of Finance (DOF) has posted all MAPS policies and procedures on its web site (<http://www.finance.state.mn.us/agencyapps/maps/index.html>).

1) Public Ownership, Public Purpose, and Use Agreements for State-Funded Projects

The Minnesota Constitution, in Article XI, Section 5, limits the appropriation of state general obligation bonds to state agencies and political subdivisions of the state. Because of this constitutional constraint, grants or loans for capital projects from bond proceeds **cannot** be made directly to non-profit or for-profit organizations.

Minn. Stat. §16A.695, subdivisions 8 and 9, summarize key requirements of general obligation bond financing. This funding can only be used:

- to finance the acquisition and betterment of **public** lands and buildings and other improvements of a capital nature that are used **to operate a governmental program**; and
- for predesign and design for specifically identified projects that involve the operation of a governmental program or activity

The same statute provides guidelines that must be followed when a capital project benefits a non-profit or for-profit organization. Generally, for a private organization to benefit from state bond proceeds, the capital project must be owned by a state agency or political subdivision who then enters into a use agreement with the private organization to provide a public program to be carried out by the private organization.

A state agency or political subdivision must be more than merely a conduit with a one-time responsibility of passing the bond proceeds through a grant agreement to the private organization. The public entity that enters into a use agreement with the private organization must be an active participant in the public program, and it must also have ongoing oversight of the program. **The Commissioner of Finance must approve all use agreements for bond-financed property.**

The Commissioner of Finance's *Order Amending Order of Commissioner of Finance Relating to Use and Sale of State Bond Financed Property* includes more detail on the requirements that apply to bond-financed property, including property that is used by or sold to a non-public party. (This document is included in Appendix 6 of the 2008 Capital Budget Instructions, which is posted online at www.budget.state.mn.us/budget/capital/2008/2008_cap_budget_inst_agency_070425.pdf.)

Agency accounting coordinators should be sure to review MAPS operating policies 0302-01, 0302-02, 0302-03 and 0302-04 when preparing Appropriation Entry (AP) forms for a capital appropriation that benefits a non-profit or for-profit organization. Agencies may also wish to consult with their Attorney General's staff if needed regarding the various legal requirements affecting state capital appropriations that benefit a non-public entity.

The contact within the Department of Finance for Minn. Stat. §16A.695 issues is Kathy Kardell. (Kathy.Kardell@state.mn.us or (651) 201-8030)

2) Standard State Grant Agreements

All general obligation capital grants must utilize a grant agreement that specifies how the bond financing will be used, what the public program is that will be operated on the bond-financed property, and that implements the provisions imposed by Minn. Stat. §16A.695. The Attorney General's office, in

cooperation with the Department of Finance, has developed standard grant agreements for state agencies to use when providing capital grants.¹ These grant agreements contain provisions covering a wide variety of applicable statutory and constitutional requirements. Standard grant agreements for bond-financed and general fund cash-financed projects are posted to the Department of Finance website and can also be obtained from the Attorney General's office. (For grant agreement documents that apply to bond-financed projects, see www.finance.state.mn.us/bonds/grantagreements/go_bonds.html)

There are two basic versions of the state grant agreements – construction grants and end grants. Construction grants provide periodic reimbursement to the grantee during project construction. A construction grant agreement will have performance bonds and a fixed price contract. The state agency, as grantor, approves the project budget, receives invoices, and makes payments of state funds to the grantee, no more often than monthly. Final payment information must include a certificate of occupancy.

End grants reimburse the grantee after the project has been completed. The grantee assumes full responsibility for completing the project, including providing whatever financing up front is needed to see the project through to completion. The state agency pays out the state appropriation for the project once the project is complete and a certificate of occupancy has been obtained.

DOF recommends that agencies use end grants whenever possible. However, agencies will need to meet with grantees and consider the dynamics of each project when deciding which grant agreement is best to use.

The state cannot advance funds to grantees prior to a signed grant agreement under any circumstances. Funds will be disbursed only when the grant agreement is signed and project costs are being incurred. No funds will be disbursed prior to the start of the project.

3) Capital Appropriations with Non-State Matching Requirements

Minn. Stat. §16B.31, subd. 2, requires state capital improvement projects to have full funding. This statute specifies that *“No plan [or specifications for construction of a state building or structure] may be adopted, and no improvement made or building constructed by the commissioner or any other agency to whom an appropriation is made for a capital improvement, that contemplates the expenditure for its completion of more money than the appropriation for it, unless otherwise provided in this section or the act making the appropriation.”*

Agencies and local government grantees must also follow Minn. Stat. §16A.502, which states, in part, *“If a state appropriation or grant for a capital project or project phase is not sufficient, by itself, to complete the project or project phase, and thus requires a commitment from other sources: (1) the commitment, including any required match, must be in an amount that, when added to the appropriation or grant, is sufficient to complete the project or project phase; and (2) the appropriation or grant is not available until the commissioner has determined that the commitment is sufficient.”*

¹ A state agency can choose to use a grant agreement form that it has customized to apply to its particular program, as long as the grant agreement implements the provisions imposed by Minn. Stat. §16A.695. DOF strongly recommends that the Attorney General's office review each new customized grant agreement form to ensure that it properly reflects applicable requirements and statutory provisions.

Local projects in the bonding bill are commonly required to provide non-state matching funds as a condition of receiving the state capital appropriation. Typically, the bill language for these appropriations specifies that the recipient may not receive the capital appropriation until the recipient has a commitment for or receipt of matching funds. Non-state funding may include federal, local and private funds.

The granting agency must provide sufficient documentation to DOF to verify that the recipient has complied with all matching requirements. This documentation must certify that non-state matching funds have been received, or the recipient has in place a legally binding commitment to secure the funding. Agencies must include this documentation when they submit the Appropriation Entry form requesting that DOF activate the project's appropriation. Once DOF approves the match, it will activate the project's state appropriation.

In some cases, additional financing is needed to complete a grant project of a political subdivision or non-profit organization (above and beyond the state appropriation plus whatever specific matching requirements are specified in the bonding bill appropriation). In these cases, the grantee must demonstrate that *all financing* is in place to complete the project, or phase, that is envisioned in the appropriation provision in the enacted bonding bill and is being specified in the grant agreement. This additional information demonstrating full project funding is required when the Appropriation Entry form to activate the appropriation is submitted to the Executive Budget Officer in DOF.

For further information, please refer to MAPS operating policy 0302-02. Questions on matching requirements should be forwarded to your Executive Budget Officer.

4) Reimbursing Local Governments

Local governments that receive a grant or a loan made from state general obligation bond proceeds often want to be reimbursed from the bond proceeds for expenses that incurred in the past and for which they have already paid their contractor from other funds.

However, Minnesota's general obligation bonds are tax-exempt. Federal tax law regulates the issuance and the use of tax-exempt bonds by states and local governments. The tax regulations severely limit the ability to use the proceeds of tax-exempt bonds to reimburse costs that have already been paid from other funds.

For example, assume a city government paid \$500,000 from its general fund to acquire land to be used to build a new government building. The payment for the land was made to the seller in September 2007. The city government received a bonding appropriation in the 2008 bonding bill of \$5,000,000 to "acquire land and to design and construct the government building." In the grant agreement that is being developed between the city and the state agency, the city government is seeking to be reimbursed for the \$500,000 cost of the land. However, it is highly unlikely that federal tax law would allow the city to be reimbursed.

As a general rule, expenses that a grantee pays from its own funds prior to the effective date of the bonding bill are not eligible to be reimbursed by bond proceeds.

Please contact Kathy Kardell at DOF (Kathy.Kardell@state.mn.us or (651) 201-8030) to discuss a grantee's particular circumstances. **Do not make any payments to local governments to reimburse project costs without first consulting the Department of Finance.**

5) Operating Program Review of Grantees for Bond-Financed Facilities

Minn. Stat. §16A.695, subd. 5, requires that "*Recipients of grants from money appropriated from the bond proceeds fund must demonstrate to the commissioner of the agency making the grant that the recipient has the ability and a plan to fund the program intended for the facility.*" Agencies administering capital grant programs funded by bond proceeds have an expanded oversight responsibility to review the financial capability of a project's operating program.

MAPS operating policy 0302-04 suggests the type of financial review that agencies should conduct to satisfy this legal requirement. Certain types of financial information will need to be requested from grantees in the course of an agency's review process. Agencies that administer capital grant programs may wish to request that certain financial documents be included in the application materials submitted by grantees.

After completing a project's operating program funding review, agencies must provide a certification of the results of their program funding review to the Department of Finance.

6) Sustainable Building Guidelines for New Buildings; Alternative Energy Sources

As required by state law, the Departments of Administration and Commerce have developed sustainable building design guidelines for all new state buildings. The primary objectives of these guidelines, known as the "B3 Guidelines," concern the energy efficiency of new state buildings. Minn. Stat. §16B.325 specifies that these guidelines "*... are mandatory for all new buildings receiving funding from the bond proceeds fund after January 1, 2004.*"

All new state buildings funded on January 1, 2004 and later must follow the sustainable building guidelines and exceed the Energy Code by thirty percent.

The sustainable building guidelines are available online at www.csbr.umn.edu/B3/index.html. Questions regarding the B3 Guidelines should be directed to Gordon Christofferson in Administration's Real Estate and Construction Services Division (Gordon.Christofferson@state.mn.us or (651) 201-2380).

For projects that are to construct a new building, or to renovate at least half of an existing building, Minn. Stat. §16B.32 requires the commissioner of administration to include designs that utilize active and passive solar energy systems, earth sheltered construction, and other alternative energy sources where feasible.

7) Predesign Review by the Department of Administration

As part of the state's efforts to make better informed capital investment decisions, Minn. Stat. §16B.335, subd. 3, specifies a predesign requirement. Most agencies and grantees are required to prepare

predesign documents for review by the Department of Administration before proceeding with design work.

The *Predesign Manual for Capital Budget Projects (Fourth Edition)* is posted on Administration's Construction Services website, and can be accessed through the following link:

www.admin.state.mn.us/recs/cs/predesign/4thedition/PDM4thE.pdf. Questions regarding the predesign process should be directed to Gordon Christofferson of the Construction Services section (gordon.christofferson@state.mn.us or (651) 201-2380).

8) Design Review by Legislative Committee Chairs

Paragraph (a) of Minn. Stat. §16B.335, subd. 1, restricts a recipient of a capital appropriation from preparing "...*final plans and specifications for any construction, major remodeling, or land acquisition in anticipation of which the appropriation was made until the agency that will use the project has presented the program plan and cost estimates for all elements necessary to complete the project to the chair of the senate finance committee and the chair of the house ways and means committee and the chairs have made their recommendations, and the chair of the house capital investment committee is notified.*"

Paragraph (b) of this same statute exempts certain types of projects from the legislative design review requirements.

Please review this statute in its entirety and consult with the legislative chairs named in the statute for further information regarding the documents that must be submitted to meet applicable legislative design review requirements.

9) One Percent for Art

Minn. Stat. §16B.35 allows an appropriation "*for the construction or alteration of any state building*" to include up to one percent for the acquisition of works of art for the public spaces of the building or its grounds. This "1% For Art" provision defines a state building as one where the construction or alternation is paid for, wholly or in part, by the state.

The 2007 legislature removed the \$100,000 cap on this provision. The law still contains three exemptions from the "1% For Art" provision, for: 1) building projects in state prisons; 2) projects where the state funding is less than \$500,000; and 3) projects where the commissioner of administration has determined that the provision is inappropriate.²

10) Project Cancellations

Minn. Stat. §16A.642, requires the Commissioner of Finance to report to the Legislature by January 1 of each odd-numbered year regarding unencumbered or unspent balances of capital appropriations enacted

² An example of a project where the "1% For Art" provision was determined to be inappropriate is the 2006 project to build a Biosafety Level 3 laboratory in the Agriculture and Health Joint Laboratory facility.

more than four years prior to that date. The reported amounts automatically cancel unless re-authorized by the Legislature.

Unspent or unencumbered balances of capital projects appropriated in the 2002 bonding bill or earlier were reported in January 2007. Unspent or unencumbered balances of projects appropriated in 2004 or earlier will be reported on January 1, 2009.

The Commissioner will report the status of projects authorized in the 2008 bonding bill to the Legislature on January 1, 2013. All funding from the 2008 bonding bill that has not been contractually obligated or expended will be cancelled at that time, unless it is reappropriated by the Legislature. To avoid having a project included in the 2013 cancellation report, agencies and grantees should be prepared to move the project along to completion.

Questions regarding project cancellations may be directed to your assigned Executive Budget Officer in DOF or Sue Gurrola. (Sue.Gurrola@state.mn.us or (651) 201-8046)

11) Reporting of Asset Preservation Expenditures

The 2006 legislature enacted Minn. Stat. §16B.307, which is the asset preservation statute. It lays out the standards that apply to asset preservation appropriations to non-higher education agencies, and it lists categories of projects that are appropriate for asset preservation appropriations.

Subdivision 2 contains a reporting requirement. Agencies that have received asset preservation appropriations must annually report a list of projects that have been funded with asset preservation money during the preceding calendar year: *“By January 15 of each year, the commissioner of an agency that has received an appropriation for asset preservation shall submit to the commissioner of finance, the chairs of the legislative committees [that oversee the agency’s appropriations], and to the chairs of the ... Capital Investment committees, a list of the projects that have been funded with money under this program during the preceding calendar year...”*³

Questions regarding asset preservation reporting may be directed to your assigned Executive Budget Officer in DOF or Jayne Rankin. (Jayne.Rankin@state.mn.us or (651) 201-8032)

Additional Questions

Please direct additional questions to your assigned Executive Budget Officer in the Department of Finance.

TJH/jasr

cc: Kathy Kardell
Jayne Rankin

³ The same statute also requires agencies to provide a list of *“asset preservation projects for which state bond proceeds fund appropriations will be sought during that year’s legislative session.”* This requirement is met through an agency’s capital budget submission for asset preservation funding.