



# Memorandum

**Date:** June 28, 2012

**To:** Commissioners and Agency Heads  
Agency Accounting Coordinators

**From:** James Schowalter, Commissioner

A handwritten signature in black ink, appearing to be "JS", is written over the name James Schowalter.

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

This memo gives an overview of key constitutional, statutory and other legal and administrative requirements regarding how state agency recipients of state capital appropriations may spend the bonding appropriations in Laws 2012, chapter 293 and chapter 287, arts. 1 and 2.

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 financial and legal advisors regarding these and other requirements.

## Important Changes

### A. Moving and Relocation Expenses

The OLA continues to express concerns about agencies’ use of bonding proceeds for moving and relocation expenses. Bond counsel guidance states that in most cases these are not bond-eligible expenses and, in cases where they might be, the legal analysis is very fact-driven and must be considered on a case-by-case basis.

In the interest of addressing the OLA’s concerns, eliminating ambiguity and avoiding excessive legal fees, **Minnesota Management & Budget (MMB) has adopted a policy that bond proceeds cannot be used for moving and relocation expenses.** This is effective immediately, including for past bonding appropriations. If a legislative appropriation specifically authorized use of bond proceeds for moving and relocation expenses, please consult MMB so we can determine if they are bond-eligible expenses.

### B. Post-Issuance Compliance Guidelines

MMB recently adopted [Tax Compliance Policies and Procedures](#) relating to its tax-exempt bonds and other tax-exempt obligations to ensure that the interest on these bonds and obligations remains tax-exempt. The IRS has expanded its compliance presence in the tax-exempt bond market through its [Tax Exempt Bonds division](#) with an increased number of questionnaires and audits and a focus on post-issuance compliance.

Please review sections I, II and III of this document carefully and let Gay Greiter, Capital Budget Coordinator, [gay.greiter@state.mn.us](mailto:gay.greiter@state.mn.us), (651) 201-8049, or Kristin Hanson, Assistant Commissioner for Treasury, [kristin.hanson@state.mn.us](mailto:kristin.hanson@state.mn.us), (651) 201-8030, know if you have any questions.

C. Tracking Bond-Financed Property

The Commissioner of MMB's *Third Order Amending Order of Commissioner of Finance Relating to Use and Sale of State Bond Financed Property* dated August 26, 2010 (the "[Commissioner's Order](#)") requires that a declaration be recorded against real estate that is purchased or improved with state general obligation bond proceeds. Since 2010, agencies and local governments have been able to request a waiver from MMB, under Section 7.02(b) of the Commissioner's Order, of the declaration requirement for bond-financed projects or portions of projects which lie within roads, highways or utility or transit corridors, easements or rights of way, subject to signing of a certification in which the bond proceeds recipient acknowledges that the property purchased and/or improved is still bond-financed property and thus subject to certain statutory requirements. **It is important that photocopies or scans of every declaration or certification be sent to Gay Greiter at MMB so that MMB can maintain the records required by Section III.A. of the Tax Compliance Policies and Guidelines.**

D. MMB Oversight of Full Funding of Capital Projects

The Office of the Legislative Auditor ("OLA") recently followed up on its 2008 General Obligation Bond Expenditures Audit and noted that agencies have not been submitting the documentation to MMB required by section 3) on page 6 below. This documentation allows MMB to determine, for capital projects where the state appropriation or grant is insufficient by itself to complete the project, whether the funding from other sources (including any required match) is sufficient to fund the project as required by Minn. Stat. Sec. 16A.502.

Agencies should send a report to Kristin Hanson, by July 30, 2012 and by July 30 for each fiscal year thereafter, which contains the following information for each program grant **as to which a grant agreement was signed** during the fiscal year which ended on the preceding June 30:

1. Name of grantee,
2. Name and location of project,
3. Amount of grant and program under which granted,
4. Amount of required match and amount and source of any other funding needed to complete the project, and
5. Method used by the granting agency to determine that the match and other funding, if any, are sufficient to complete the project.

Agencies do not need to send documentation provided by grant recipients to show that the additional funding has either been received or committed, but agencies should keep that information in their files in case it is requested by MMB or by the OLA.

Each grant will only need to be reported to MMB once, unless the project budget increases and we need to verify that it is still fully funded. Agencies can use a Microsoft Word table or Excel spreadsheet for the submitted report if that is easier for them.

E. Solar Energy in State Buildings

New Minn. Stat. Sec. 16B.323, enacted in the 2012 omnibus bonding bill, Laws 2012, ch. 293, sec. 32, provides that "*a project for the construction or major renovation of a state building, after the completion of a cost-benefit analysis, **may** include installation of 'Made in Minnesota' solar energy*

*systems of 40 kilowatts capacity on, adjacent, or in proximity to the state building.” A “state building” is defined as a building whose construction or renovation is paid wholly or in part by the state from the bond proceeds fund, and thus does not mean only buildings owned by the state. The cost of the solar system may not exceed 5% of the bonding appropriation for the construction or renovation.*

F. Capital Projects Jobs Reporting Requirement

Section 28 of the 2012 bonding bill added a new jobs reporting requirement for all projects which receive state capital funding from any state source (and thus not just bonding proceeds) by adding new subd. 4 to Minn. Stat. Sec. 16A.633:

*Subd. 4. Report on jobs created or retained. By September 1 of each odd-numbered year, the commissioner [of MMB] must report to legislative committees with jurisdiction over capital investment on the jobs created or retained as a result of capital project funding by the state, whether with state general obligation bond proceeds or other state funding sources, during the previous biennium. Each state agency must provide the commissioner the information necessary, and must require its capital project grantees to provide the information necessary, for the commissioner to make the report. The report must include, but is not limited to, the following information: the number and types of jobs for each project, whether the jobs are new or retained, where the jobs are located, and pay ranges of the jobs. The Board of Regents of the University of Minnesota, the Board of Trustees of the Minnesota State Colleges and Universities, and each state agency receiving an appropriation for a capital project shall collect and provide the information at the time and in the manner required by the commissioner.*

MMB is in the process of developing a system which will allow agencies to report this information to MMB in a manner that MMB can compile it for reporting to the legislature. Further information will be forthcoming.

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The remainder of this memo is a refresher on the 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) Qualified capital expenditures
- 7) Staff costs for project management
- 8) Sustainable building guidelines for new buildings; alternative energy sources; recycling construction and demolition waste

- 9) Predesign review by the Department of Administration
- 10) Design review by legislative committee chairs
- 11) Up to one percent for art
- 12) Project cancellations
- 13) Reporting of Asset Preservation Expenditures

More information on these topics may be found in the [Capital Grants Manual](#). Please also see SWIFT operating policy 0302-01 that applies to capital appropriations. SWIFT policies and procedures can be found [here](#) on MMB's web site.

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

The Minnesota Constitution, 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 or to Indian tribes.

Minn. Stat. Sec. 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. For a private organization to benefit from state bond proceeds, the capital project must be owned by a state agency or political subdivision that then enters into a use agreement with a private organization to provide the public program. Such public ownership can be a fee simple interest or a sufficiently long-term lease or easement interest.

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 MMB must approve all use agreements for bond-financed property.**

The Commissioner's Order includes more detail on the requirements that apply to bond-financed property, including property that is used by a non-public party. Agency accounting coordinators should review SWIFT operating policy 0302-01 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 staff regarding the various legal requirements affecting state capital appropriations that benefit a non-public entity.

## 2) Standard State Grant Agreements

All general obligation capital grant agreements must describe how bond financing will be used, identify the public program to be operated on bond-financed property, and otherwise ensure that the provisions of Minn. Stat. Sec. 16A.695 are implemented. The Attorney General's office, in cooperation with MMB, has developed standard grant agreements for state agencies to use when providing capital grants.<sup>1</sup> 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 on MMB's website [here](#).

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. There is a third version of state grant agreement which is used when the grant will fund only the pre-design and/or design phase of a project.

End grants reimburse the grantee after the project has been completed. The grantee assumes full responsibility for completing the project, including providing up-front financing as 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.

MMB 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 a grant agreement is signed and project costs have been incurred. No funds will be disbursed prior to the start of the project.

## 3) Capital Appropriations with Non-State Matching Requirements

Minn. Stat. Sec. 16B.31, subd. 2, requires state capital improvement projects to have full funding. This statute specifies that *“No plan [for specifications for constructing or improving a state building or structure] may be adopted, and no improvement made or building constructed by the commissioner [of the Department of Administration] 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 be aware of Minn. Stat. Sec. 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*

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<sup>1</sup> 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. Sec. 16A.695. MMB requests that MMB or the Attorney General's office review a customized grant agreement form to ensure that it properly reflects applicable requirements and statutory provisions.

*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 [of MMB] has determined that the commitment is sufficient.”*

Local projects are commonly required to provide matching funds as a condition of receiving a state capital appropriation. Non-state funding may include federal, local and private funds or other state funding if that is permitted by the program or appropriation language. The granting agency must provide sufficient documentation to MMB to verify that the recipient has secured sufficient funding to complete the project, including any matching requirements. Such funding must have been received or a legally binding commitment to provide the funding must be in place. Below are some examples of matching funds which are sufficiently committed and required documentation thereof:

- Cash in hand – bank statements for segregated accounts, copies of checks
- Federal funds – line items in approved federal budgets, grant award letters from federal agencies. Federal authorizations by themselves are not sufficient.
- Local government match – line items in approved local government budgets, voter-approved bond referenda, executed loan agreements with lenders
- Private contributions – pledges which have been received in cash (see documentation for “Cash” above) or that are backed by a loan or irrevocable letter of credit. Future pledges by themselves are not sufficient.
- In-kind contributions (such as land, buildings, construction materials) – documentation must be received with the name of the contributor, a description and the value of the contribution, and details of how the value was determined.

When MMB sets up appropriations for projects specifically earmarked in bonding legislation where a match is required, the appropriation is deactivated. Agencies must include appropriate documentation when they submit the Appropriation Entry (AP) form requesting that MMB activate the appropriation. Once MMB approves the match, the appropriation will be activated.

If the project is intended to be completed in phases, the grantee must demonstrate that *all financing* is in place to complete the project or phase of the project that is envisioned in the appropriation language and as 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 (“EBO”) at MMB.

For further information, please refer to SWIFT operating policy 0302-01.

#### **4) Reimbursing Agencies or Local Governments**

Agencies and local governments that receive a grant or loan from state general obligation bond proceeds often want to be reimbursed for past expenses which they have already paid from other funds. As a general rule, expenses that an agency or grantee pays from its own funds prior to the effective date of the bonding bill are not eligible to be reimbursed from bond proceeds. The 2012 omnibus bonding bill (Laws 2012, chapter 293) became effective on May 12, 2012. Trunk highway fund and trunk highway bond-funded project appropriations were enacted in Laws 2012, chapter 287, Article 1, which became effective on May 11, 2012.

Federal tax law regulates the issuance and use of tax-exempt bonds by states and local governments. 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.

Expenses incurred before enactment of the relevant bonding bill should be paid for from other project funding sources, such as the local match. Agencies receiving reimbursement requests should not make any payments out of bond proceeds for project costs accrued prior to enactment of the bonding bill without first consulting MMB.

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

Agencies administering capital grant programs funded by bond proceeds have oversight responsibility to review the financial capability of a grant recipient's operating program. Minn. Stat. Sec. 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.*"

SWIFT operating policy 0302-01 provides guidance as to the 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 MMB.

#### **6) Qualified Capital Expenditures**

General obligation bond proceeds may only be used for qualified capital expenditures. Eligible costs include land acquisition, predesign, design, construction, major remodeling (if it adds to the value or life of a building and is not of a recurring nature), and other improvements or acquisitions of tangible fixed assets of a capital nature.

General operating expenses, overhead, master planning, maintenance, operating costs, software and personal property such as computers are not qualified expenses. Equipment may be eligible if purchased and installed upon initial acquisition and construction of a building, expansion or major remodeling. Expenses that are not qualified capital expenses must be paid from funds other than general obligation bond proceeds or from general fund cash if not prohibited by law.

Agencies and grantees may use bond proceeds only for direct capital costs and not for depreciation, amortization, overhead, general administration or similar costs.

#### **7) Staff Costs for Project Management**

State agencies are strongly encouraged to charge the time of state employees working on capital projects to non-bond funding sources because of the undesirable practice of amortizing such salary costs over the 20-year life of state general obligation bonds. On October 20, 2009, MMB adopted a [policy](#) regarding use of general obligation bond proceeds to fund staff costs.

Agencies may use general obligation bond proceeds to pay for staff costs for bonding appropriations authorized in the 2010 legislative session and thereafter and for earlier appropriations if explicit statutory authority was given to use G.O. bond proceeds to fund staff costs.

Agencies must notify MMB of their intention to capitalize the costs of staff prior to expending any bond appropriations for this purpose. Staff time expended on capital projects must be tracked on a daily basis by project and by each individual recording time on the project. Agencies are required to submit a memorandum to their EBO and to Gay Greiter for approval by MMB, which outlines their proposed plan for tracking and reporting all agency staff time funded with G.O. bond proceeds and an estimate of total staff time to be charged to each project.

After approval of its plan by MMB, each agency must submit a quarterly report to its EBO and to Gay Greiter detailing the staff costs being charged to each capital project. MMB prepared a template summary cover sheet for agencies to submit these reports. MMB is required to report annually on January 15 to the legislature as to each agency's expenditures of capital appropriations for staff costs and its compliance with MMB's policy on staff costs.

#### **8) Sustainable Building Guidelines for New Buildings; Energy Conservation; Alternative Energy Sources; Recycling Construction and Demolition Waste**

Under Minn. Stat. Sec. 16B.325, all new state buildings funded after January 1, 2004 and all major renovations funded after January 1, 2009 from general obligation bond proceeds must follow the sustainable building guidelines and exceed the state energy code by 30%. "State building" is defined as any building which receives bond funding.

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" or the Minnesota Sustainable Building Guidelines (MSBG), relate to the energy efficiency of new state buildings and are available [online](#). Questions regarding the MSBG should be directed to Pat Smith at (612) 626-9709, [smit2059@umn.edu](mailto:smit2059@umn.edu).

All capital improvement projects must comply with applicable energy conservation standards, including Minn. Stat. Secs. 216C.19 to 216C.20. Information and technical assistance may be obtained from the State Energy Office in the Department of Commerce on energy conservation and alternative energy development at 800-657-3710 (MN only) or 651-296-5175, [energy.info@state.mn.us](mailto:energy.info@state.mn.us).

Minn. Stat. Sec. 16B.32 relates to energy use by state-owned buildings. Under subd. 1, for construction of a new building or renovation of at least half of an existing building, the commissioner of administration must include designs that utilize active and passive solar energy systems, earth sheltered construction, and other alternative energy sources where feasible. Under subd. 1a, a state agency preparing a predesign for a new building must consider using wind and solar energy for at least 2% of the building's energy needs.

Minn. Stat. Sec. 16B.327 requires recycling of at least 50% of nonhazardous construction and demolition waste (measured by tonnage or volume) generated by construction, renovation or demolition of any building owned or leased by a state agency, MnSCU or the University of Minnesota. It applies to

appropriations of \$5,000,000 or more enacted after January 1, 2011 if a recycling facility is located within 40 miles of the project.

### **9) Predesign Review by the Department of Administration**

As part of the state's efforts to encourage better informed capital investment decisions, agencies and local government grantees are required to prepare predesign documents for review by the Department of Administration before proceeding with design work (Minn. Stat. Sec. 16B.335, subd. 3). This requirement applies to all capital projects unless specifically exempted by the statute.

The *Predesign Manual for Capital Budget Projects (Fifth Ed., Feb. 2010)* is posted on the Department of Administration's website [here](#). Questions regarding the predesign process should be directed to Gordon Christofferson at Construction Services, [gordon.christofferson@state.mn.us](mailto:gordon.christofferson@state.mn.us), (651) 201-2380.

### **10) Design Review by Legislative Committee Chairs**

Paragraph (a) of Minn. Stat. Sec. 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 of representatives Ways and Means Committee and the chairs have made their recommendations, and the chair of the house of representatives 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.

### **11) Up to One Percent for Art**

Minn. Stat. Sec. 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. Please note section 7 of this memorandum regarding qualified capital expenditures. For this purpose, a state building as one where the construction or alteration is paid for, wholly or in part, by the state.

The law provides for three instances where none of the bonding appropriation may be spent on art under the "1% for Art" provision: 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.

### **12) Project Cancellations**

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

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

The Commissioner will report the status of projects authorized in the 2012 bonding bill to the Legislature on January 1, 2017. Accordingly, all 2012 capital projects are being entered in SWIFT with an end date of December 31, 2016. All funding from the 2012 bonding bill that has not been contractually obligated or expended by December 31, 2016 will be cancelled effective July 1, 2017 unless it is re-appropriated by the Legislature. To avoid having a project included in the 2017 cancellation report, agencies and grantees should be prepared to move the project along to completion.

### **13) Reporting of Asset Preservation Expenditures**

All of the asset preservation statutes (M.S. Sec. 16B.307, Sec. 16A.632 (CAPRA), 84.946 (natural resources) and 135.046 (HEAPR) contain a reporting requirement. Agencies that have received asset preservation appropriations must report to specified legislative committee chairs and to MMB by January 15 of each year a list of projects that have been funded with asset preservation money during the preceding calendar year. The statutes also require agencies to provide a list of priority asset preservation projects for which appropriations will be sought during that year's legislative session. This latter requirement is met through an agency's capital budget request through MMB for asset preservation funding.

### **Questions**

Agencies should direct any questions about these topics or any other capital project questions to their assigned EBO or Gay Greiter at MMB, [gay.greiter@state.mn.us](mailto:gay.greiter@state.mn.us), (651) 201-8049.