Chapter 4

FINANCING GUIDELINES

Updated This chapter is prepared in collaboration with the Office of the State Treasurer (OST) and provides financing guidelines for the issuance of general obligation bonds and Certificates of Participation (COPs). The main purpose is to ensure that the state's debt issuance meets the IRS' requirements for tax-exempt obligations. The chapter provides an overview of the methods of finance the state uses; allowable and non-allowable capital budget cost financed by tax-exempt financings; and the private activity restrictions on tax-exempt financings. Finally, this chapter reviews a questionnaire used to evaluate the appropriate funding source for bond/COP-funded projects.

4.1 Methods of finance

Capital projects are financed with cash balances, revenues received over time or with proceeds of financings. Most state financings are conducted through the issuance of general obligation bonds or through COPs. Both general obligation bonds and COPs are issued by the state several times a year in the public securities market.

State bonds and COPs are usually issued as tax-exempt (i.e., the interest paid to investors is exempt from federal income tax) securities, as tax-exempt borrowing rates are lower than taxable rates. Tax-exempt financings are subject to federal tax regulations regarding the types of projects being financed, the pace at which proceeds are spent and the use of the asset during the financing term.

General obligation bonds

Various purpose general obligation (VPGO) bonds are the traditional form of state debt financings for non-transportation capital projects. VPGO bonds are payable from general state revenues and backed by the state's pledge of its full faith, credit, and taxing power. Unless specifically exempted, VPGO bonds are subject to a state constitutional debt limit, which requires that the maximum annual payment of principal and interest on debt subject to this limit not exceed a specified percentage of average general state revenues for the six preceding fiscal years. VPGO bond sales generally occur semiannually to provide funding for six months of expenditures on a variety of capital projects across the state.

The State Finance Committee (SFC) authorizes the issuance of bonds and other state obligations that have been approved by the Legislature. The SFC, which is comprised of the governor, lieutenant governor, and treasurer, implements financing policies, and determines the conditions, covenants, terms, and requirements of state financings, as applicable.

Program parameters. Proceeds of tax-exempt bonds must be spent on capital expenditures, in accordance with state accounting guidelines and federal tax laws applicable to tax-exempt obligations. Proceeds of tax-exempt bonds may be spent on grants, but loans to entities besides state or local government units – including non-profit organizations, the federal government, or federal agencies – are not allowed under federal tax laws. Certain upfront costs such as design, delivery and setup, and training may qualify for financing. Expenditures for sales and use tax on purchases of equipment and construction of capital projects can also be financed.

More detailed information on the allowable uses of tax-exempt financing is provided later in this chapter. All property financed on a tax-exempt basis is subject to federal tax restrictions regarding private business use (see the private activity restrictions on tax-exempt financing section below).

Certificates of participation

The issuance of COPs provides the state with an alternative way to finance essential equipment and real estate acquisitions, including construction, over a multi-year period. The program is structured by agencies entering into financing contracts (aka lease-purchase, or lease lease-back) for the property being acquired. These individual financing contracts are then pooled under the state's master financing agreements, which provide the security for the issuance of COPs that are sold to investors. The proceeds from the sale of COPs are then used to reimburse the agency for the cost of the acquisition. The pooled approach provides agencies with the benefits of economies of scale and access to the state's low-cost, tax-exempt financing rates. COPs offer investors leasehold interest in the property, and the promised revenue stream from the repayment of the financing contracts made by state agencies.

This form of financing contracts is subject to approval by the State Finance Committee (SFC), which also approves the aggregate number of financing contracts outstanding. SFC guidelines for use of the program are provided in the Guidelines for Use of Financing Contracts on the OST's website.

State law requires prior legislative approval of real estate financing contracts in the capital budget. Most equipment financings do not require explicit legislative authorization, although the OST policy requires legislative approval prior to financing major acquisitions of equipment or information systems.

Program parameters. Proceeds generated from financing contracts and the issuance of COPs must be spent on capital expenditures, in accordance with state accounting guidelines and federal tax laws. All property financed on a tax-exempt basis is subject to federal tax restrictions regarding private business use (see the private activity restrictions on tax-exempt financing section below). Financing contracts cannot be used to provide funds for grants or loans. Proceeds of financing contracts must be spent on assets serving an essential public purpose. Agencies must represent that the property is essential for carrying out its functions and responsibilities.

Proceeds from a COP sale are provided to an agency exclusively on a reimbursement basis. Please note, that in keeping with IRS tax-law, an agency must submit a Notice of Intent to Finance (NOI) to OST no later than 60 days after making the expenditure for it to be eligible for reimbursements.

Expenditures for sales and use tax on purchases of equipment and construction of capital projects can be financed. Certain upfront costs such as design, delivery, and setup, may qualify for financing on a reimbursement basis. Note that design costs may not be financed before equipment is acquired or construction begins because design, by itself, does not create a tangible asset as required by the COP program to provide security for investors who purchase COPs. More detailed information on the allowable uses of tax-exempt financing is provided in the next section.

A real estate project must be ready to proceed before it is financed. For acquisitions, agencies must first acquire the building or land and obtain title to the property prior to the issuance of the COPs. Financing of the cost of acquisition is then provided on a reimbursement basis. For new construction, OST requires agencies to have entered into a construction, design-build or general contractor/construction manager (GCCM) contract for the project prior to the issuance of the COPs. Construction projects are subject to public works requirements. IRS guidelines for the use of tax-exempt proceeds require such funds to be spent within 18 months from the sale date of the COPs.

4.2 Long-term, tax-exempt financing restricted to capital projects Updated

Regulations adopted by IRS restrict the purposes for which tax-exempt bonds and COPs may be issued. IRS regulations severely limit the ability to issue long-term, tax-exempt obligations to finance current operating expenses. Additionally, for long-term tax-exempt financings, the IRS generally requires that the useful life of a capital project being financed exceeds the final maturity of the bonds or COPs issued for the project. For multiple projects financed together through bonds, the useful life is the average useful life of all the projects financed. Property financed through COPs are monitored on a project-to-project basis. The information below distinguishes allowable capital purposes from non-allowable operating expenses.

Agency administrative and staffing costs

Proceeds of tax-exempt bonds or financings are intended for the acquisition, construction, and renovation of capital assets. Do not use them to subsidize operating costs such as ordinary maintenance or administrative staff expenses. IRS tax rules relating to staffing costs are very restrictive. As part of the reimbursement process for COP financed projects, OST requires detailed accounting records to document staff time or other labor charges. Contact OST for further information on the requirements. In general, treasury regulations (primarily, §1.148-1, 1.148-2, and 1.148-6) do not allow for any costs not directly related to a capital project to be funded with long-term financings.

Allowed:

- Project-related administrative costs for tasks directly related to a financed project, including project support services such as processing agreements, contracts and change orders, managing bid processes and verifying invoices. Project-related administrative costs must be identified as such in accounting records.
- Project-related management fees for project design, land use applications, environmental impact statements and other environmental assessments, hazardous material assessments and building code plan review directly related to a financed project. This also covers project-related management costs related to consultant selection, contract negotiation, administration of consultant agreements and public works contracts for individual capital projects that are directly related to a financed project. These costs must be identified as such in accounting records.
- Staff costs for the time and expenses directly related to coordinating and delivering a project. Project-related staff costs must be identified as such in accounting records.
- Tasks associated with the support of project management operations for multiple projects including staff management, staff support, accounting and management of public information that are directly related to a financed project.

Not allowed:

- Regular staff operating costs.
- Agency administrative costs related to capital budget development, capital facility development, long-range budget planning and policy initiatives.
- Non-project specific tasks associated with regulation and policy development, contract development, interagency initiatives, or legislative oversight.
- Non-project specific tasks associated with overall general comprehensive planning for facilities and infrastructure, the identification and prioritization of capital projects and the preparation of agency capital requests. The provision of emergency services and infrastructure management.

Acquisition – land and buildings

Allowed:

- Expenditures for the acquisition of real property, whether obtained by purchase or condemnation under the applicable eminent domain laws of the state, including expenses directly and necessarily related to such purchase or condemnation.
- The cost of improvements to real property, such as buildings, structures, land improvements, roads, and bridges. Costs may include land and improvement costs, appraisal fees, title opinions, surveying fees, real estate fees, title transfer taxes, easements of record with an extended term, condemnation costs and related legal expenses.
- Relocation costs that are payments made to owners or occupants of property that the state is acquiring. These costs can be financed long-term when paid pursuant to federal or state statutes.

Planning and consultant services for predesign and design work

Allowed:*

- Preliminary technical studies developed from program statements that reflect the functional characteristics and architectural requirements of a specific capital improvement project (predesign).
- Architectural and engineering services, such as schematic design, design development and construction documents.
- Archeological and historic structure survey, consultation, and consultant services.
- Reimbursable expenses provided in an executed contract for professional and technical services.
- Artwork funding as required by RCWs 28A.335.210, 28B.10.027 and 43.17.200.
- Fees for construction management and observation.
- LEED certification fees as part of a construction project.

Not allowed:

- Expenditures for general long-range development plans, master plans, historical or archeological research, feasibility studies, statements, capital and maintenance project planning, or other similar expenditures which are not associated with a specific capital project.
- Unpredictable or unusual legal expenses (other than those associated with land acquisition) which are not ordinarily provided in the budget for a capital project.

***Additional COP financing restrictions:** Design costs for a capital project may not be financed with a COP before construction begins because design, by itself, does not create the tangible asset which is necessary to secure the financing. Once construction contracts are executed and COPs are issued, certain upfront costs such as design, delivery, setup, and some training may be reimbursed from COP proceeds.

Construction

Site improvement costs

Allowed:

- Site improvement such as construction or replacement of sidewalks, bridges, ramps, curbs, pedestrian bridges, and tunnels, building terraces, retaining walls and exterior lighting; rerouting of utilities; and erosion control.
- Demolition of buildings and structures, clearing, grubbing, and grading if preceding a financed project to be undertaken on the same site.
- Artwork funding as required by RCWs 28A.335.210, 28B.10.027 and 43.17.200.

Not allowed:

- Routine maintenance of land improvements.
- Expenditures to acquire or construct temporary facilities or for facilities where abandonment or replacement is imminent. This does not include temporary facilities required during construction.

Roadwork

- **Allowed:** Expenditures related to the construction, extension, replacement, reconstruction or upgrading of a new road or parking lot. The following are considered part of roadwork costs: all necessary signing, landscaping, erosion control, drainage, lighting, bridges, safety, and control structures.
- **Not allowed:** Repairs or resurfacing of existing roads to temporarily extend useful life are not allowed.

Facilities preservation

Allowed:

- Expenditures for the reconstruction, preservation and improvement of existing buildings or structures that materially extend their useful lives, including:
  - » Site developments necessarily required or related to the preparation of a site for reconstruction purposes (see "Site Improvement Costs").
  - » Required built-in, special purpose or other fixed equipment where such equipment is permanently affixed or connected to real property in such a manner that removal would cause damage to the real property to which it is affixed.
  - » Expenditures for the installation or replacement of water control structures such as dams, culverts, aqueducts, drainage systems, locks, spillways, reservoirs, and channel improvements.
- Interior work including demolition, moving walls, new carpet or floor surfaces, new finishes, replacement of electrical and plumbing facilities and installation of new equipment.

Not allowed:

- Normally recurring expenses.
- Labor fees associated with moving equipment between facilities.
- Ordinary maintenance such as patching, painting, caulking, weatherproofing, insulating, adding storm windows, replacing doors, replacing gutters and shingles, repairing vandalism or cleaning. An aggregation of ordinary maintenance does not create a long-term financed capital project.

Utilities, safety, and codes

- **Allowed:** Expenditures for the acquisition, construction, replacement, modification, or extension of utility systems, including construction or replacement of utility lines between buildings, replacement, or installation of utilities to off-site supply systems, and replacement of complete boiler or central air conditioning or ventilation systems.
- **Not allowed:** Minor replacement of corroded or leaking pipes inside a facility; replacement of unsafe or undersized wiring; repairs to stop leaks; replacement of heating or cooling coils; replacement of radiators, fans, or motors; re-tubing of boilers; addition of controls or valves for energy conservation as a standalone project or replacement of thermostats, timers and other items that are consumed or worn out in the ordinary course of use of a capital facility.

Project-related equipment – (see below for a standalone equipment financing)

Allowed:

- Built-in equipment permanently attached to the building or improvement and considered to be an integral part of the structure, without which the building or improvement will not function. Built-in equipment is generally included in the base construction budget and estimate. Examples include plumbing fixtures, heating, ventilation and air-conditioning equipment, electrical equipment, elevators, and escalators.
- Fixed equipment attached to the building or improvements for purposes of securing the item and contributing to the facility's function. Fixed equipment is generally included in the base construction budget and estimate. Examples of fixed equipment financed as part of a larger building project could include shelving, cabinets, bolted furniture, solar arrays, or electric vehicle charging stations.
- Some movable equipment can be considered long-term and an appropriate use of bond or COP funding if it is part of a new construction or major renovation project. Examples include movable equipment that is necessary for the functioning of the facility and in place in support of a program but is not necessarily attached to the facility. Examples of allowable movable equipment include desks, conference tables and chairs, cubicle partitions, non-consumable lab equipment, picnic tables, and unaffixed appliances. Movable equipment included in a capital project should be included in a separate equipment budget and estimated as furniture, fixtures, and equipment (FF&E) in the C-100 cost estimate. For renovation projects, FF&E should be repurposed and reused whenever possible. A separate operating budget/IT package to coincide with opening a building should be submitted for items traditionally funded out of the operating budget.
- Some costs of purchasing or developing information/software systems may be allowed under certain circumstances. For additional information, consult with OST staff. Please also consider whether your IT project falls under Office of the Chief Information Officer (OCIO) oversight.†

Not allowed:

- Consumable inventories, as defined in the State Administrative and Accounting Manual (SAAM), are supplies consumed in the course of an agency's operation or incidental items held for resale. Examples include office, janitorial and chemical supplies, and laboratory glassware.
- Equipment traditionally funded out of the operating budget, IT, and office equipment such as computers, fax machines, networking equipment, projectors, copiers, custodial equipment, and grounds equipment cannot be financed as part of a capital project request. However, certain equipment can be financed with a standalone COP (see below) or cash accounts.
- Spare or replacement parts for equipment.
- Temporary equipment to be used for a period less than its useful life. For example, research equipment for a short-term project.

Equipment – standalone (COPs only)

While generally not authorized through the capital budget, certain equipment may be financed directly by agencies through the issuance of COPs. This includes standalone acquisitions (i.e., vehicles), or other types of equipment that may not be eligible to be included in a capital project request (i.e., computers). The term of the equipment financing must be less than or equal to the maximum useful life of the asset. The useful life is determined by the SAAM capital asset class codes and useful life schedule.

Allowed:

- Tangible equipment with a useful life greater than two years and a total acquisition amount greater than $10,000 (i.e., vehicles, computers, office furniture).
- Energy efficiency upgrades to a facility (i.e., HVAC, LED lighting, solar panels).
- IT Hardware can be financed along with associated licenses, software, and warranties, with certain limitations. (See **Additional COP financing restrictions** below)

Not allowed:

- Consumable inventories, as defined in the SAAM, are supplies consumed during an agency's operation or incidental items held for resale. Examples include office, janitorial and chemical supplies, and laboratory glassware.
- Software as a Service (SaaS), Cloud based IT products or other IT service agreements.
- Temporary equipment to be used for a period less than its useful life. For example, research equipment for a short-term project.

Additional COP financing restrictions: Agencies considering COP financing for IT projects should contact OST early in the planning process and be aware that prior legislative approval is required for major acquisitions. Agencies are required – without exception – to receive explicit vendor permission to grant a security interest in all elements of the information system contained within the financing request.

4.3 Private activity restrictions on tax-exempt financing

All agencies planning to finance capital projects with bonds or COPs, and who anticipate engagements with nongovernmental entities on their projects, are strongly encouraged to consult with OST early in the process.

Private business use

In general, Congress and the federal government consider the tax exemption for interest on state and local bonds to be a federal subsidy provided to state and local governments. This is because the federal government foregoes the revenues that it would otherwise receive from income taxes imposed on interest income received by taxpayers who own municipal bonds. Therefore, the provisions of the federal Code and related U.S. Treasury regulations that apply to tax-exempt obligations are intended to restrict the benefits of this federal subsidy to governmental purposes of state and local governments and not to allow benefits of the subsidy to be transferred to persons other than state and local governments.

"Private business use" means use by any person other than the state or another local government unit of the state and includes use by any private for-profit or nonprofit corporation (e.g. 501(c)(3) organizations), limited liability company, general or limited partnership, association or an individual person engaged in a trade or business activity. It also includes use by the federal government or any federal agency. Private business use includes: ownership by the nongovernmental person of the financed property or use of the financed property by a nongovernmental person under a lease, management contract (unless it is a "qualified" management contract under IRS guidelines), "output contract" (such as a contract to purchase water or electricity produced by a financed facility), research agreement (with certain exceptions under IRS guidelines), a "naming rights" contract, or any other arrangement that provides similar "special legal entitlements" to a nongovernmental person to use the financed property. However, the use of financed property by a nongovernmental person simply as a member of the public or under certain, specified short-term use arrangements (involving terms of use not exceeding 50, 100 or 200 days, depending on the type of arrangement) do not result in private business use. Also, use of financed property by private individuals not engaged in a trade or business activity is not private business use.

In summary, an issuer must reasonably expect on the issue date that the issue will not meet the following tests at any time during the term of the issue:

1. Private Business Use Test **and** Private Security or Payment Test, **or**
2. Private Loan Financing Test

Limits on private business use (private business use test) Updated

In general, the amount of proceeds for private business use of a tax-exempt governmental financing is limited to the lesser of 10% or $15 million of proceeds of the issue. In addition, no more than 5% of the proceeds of the issue may be used for any "unrelated" private business use — i.e., a private business use that is not functionally related to the governmental purpose of the tax-exempt financing. These limitations are measured based on the average amount of private business use in each year during a measurement period generally corresponding with the overall term of the bond or COP issue.

Private payments or security (private security or payment test)

An issue of tax-exempt bonds with private business use in excess of the limits described above would not violate private activity bond restrictions *unless* the state also expects to receive payments from private business users for their use of the financed property (or payments by others in respect of property that is used for private business use) having a present value exceeding 10% of the present value of debt service on the bonds, regardless of whether those payments are pledged to pay the bonds. For this reason, bond proceeds used to make grants may be used for private business use so long as the state has no expectation or right to receive payments from the grantee (except only for violations by the grantee of conditions of the grant). Loans to nongovernmental persons from bond proceeds are not permitted as there would be both private use and private payments.

Moreover, use of tax-exempt bond proceeds to make loans to governmental persons also may be disallowed because of federal tax compliance issues relating to monitoring of the actual expenditure and investment of bond proceeds loaned to the governmental borrower. This is because the bond proceeds are treated as "spent" only when spent by the borrower and not when used to make the loan.

However, for COPs, the analysis differs in that the focus is on the amount of private business use, regardless of whether the state receives any payments in respect to the financed property. Like tax-exempt bonds, a COP-financed property would generally violate private activity bond restrictions if payments from private business users of the financed property were to exceed the applicable limitations. However, there is a second consideration because the financed property itself is pledged as security for the COPs. Private business use of the financed property results in a corresponding amount of private security, which is a violation of private activity bond restrictions regardless of the amount of private payments. That is, if a portion of the COP-financed property representing more than the lesser of 10% or $15 million of proceeds of the COP issue is used for private business use, or if more than 5% of the proceeds of the issue is used for any "unrelated" private business use, this would cause the issue to violate the restrictions on private security as distinguished from private payments.

Strict limit on tax-exempt financing of private loans (private loan financing test)
In addition, under a separate and independent restriction, no more than the lesser of 5% or $5 million of the proceeds of an issue may be used, directly or indirectly, to make or finance loans to any person other than a state or local government unit. This is referred to as the "Private Loan Financing Test." Because of the size of the state's bond issues, the lower $5 million limit almost always applies.

In addition to IRS restrictions, the use of state bond proceeds, whether tax-exempt or taxable, to make loans to private persons or entities may be subject to additional constitutional restrictions. Please discuss with your OFM capital budget analyst.

Use of taxable obligations for private use portions of capital projects
A capital project that is expected to involve both private business use **and** private payments, **or** a private loan as described above may require some of or all the financing to be executed on a taxable rather than tax-exempt basis or require the use of funds not derived from a borrowing to pay the cost of that part of the project expected to be used for a private business use. If the project requires taxable funding, the agency may request funding from the State Taxable Building Construction Account (Account 355). Consult your OFM capital budget analyst for more information.

Most recent bond acts include provisions which permit the state treasurer, on behalf of the SFC, to cause bonds authorized to be issued as tax-exempt bonds instead to be issued as taxable bonds if necessary to comply with IRS requirements. Recent bond acts also permit authorized taxable bonds to be issued as tax-exempt bonds using a similar approval process if code requirements have been met.

Examples:

1. If a state agency leases excess office space in a financed building to commercial businesses, a federal agency, or a private non-profit organization, the portion of the proceeds allocated to the cost of the privately leased space is considered used for nongovernmental purposes.
2. Suppose bond proceeds are used to make a loan to a port district for the construction of an industrial building, and that the port district constructs the building and leases space in the building to various commercial tenants and uses rental income from the building to repay the state loan. In this case, the bond proceeds used to make the loan to the port district would be treated as a private business use.
3. If proceeds of a bond issue with a 25-year term are used to construct leasehold improvements for a state agency that leases office space in a privately-owned building for a term of 15 years, and the estimated useful life of the leasehold improvements is 20 years, the proceeds of the bond issue allocable to the cost of the leasehold improvement that will revert to the private building owner at the end of the lease term would be treated as used for private business use.
4. If proceeds are loaned to a housing authority to build an apartment building that the housing authority leases to a separate limited partnership in which the housing authority is the general partner and private investors are limited partners, the financed apartment building is considered used for private business use, and the private loan financing test would be met.
5. If proceeds are loaned to a city to build a sewage treatment plant, but the city enters into a long-term management contract with a private company to operate the sewage treatment plant for the city, and the management contract fails to meet IRS requirements for a "qualified management contract," the plant is considered used for a nongovernmental purpose.

An agreement by a nongovernmental person (such as a business corporation or the federal government) to sponsor research performed by a governmental person (such as a state university) may result in private business use of the property used for the research. Consult with OST as it may be possible to structure research agreements with nongovernmental persons to avoid private business use of the property.

Reimbursements of prior expenditures with tax-exempt bond proceeds

IRS Code (26 CFR § 1.150-2) allows a bond issuer to use the proceeds of its issuance to reimburse prior expenditure **provided** that the issuer has adopted an official intent to for the expenditures to be reimbursed. An official intent declaration allows for the reimbursement of expenditures made up to 60 days before the adoption of the official intent. With an adopted official intent declaration, expenditures can be reimbursed with bond proceeds up to 18 months after the expenditures have been made (or up to three years after a project is placed in service or abandoned).

The state meets the official intent requirements by including in each capital budget bill (that appropriates expenditures from tax-exempt bonds) a section like the following:

> *"To the extent that any appropriation authorizes expenditures of state funds from the state building construction account, or from any other capital project account in the state treasury, for a capital project or program that is specified to be funded with proceeds from the sale of bonds, the legislature declares that any such expenditures for that project or program made prior to the issue date of the applicable bonds are intended to be reimbursed from proceeds of those bonds in a maximum amount equal to the amount of such appropriation."*

With respect to reimbursement of prior expenditures with proceeds of COPs, OST requires state agencies who participate in the COP program to submit a NOI, which includes the required reimbursement declaration.

4.4 Financing framework

General obligation bonds

Bond authorizations. All state general obligation debt must be authorized by a 60% vote by the Legislature. In addition, no bonds may be issued without prior legislative appropriation of the proceeds. Bonds are issued by the SFC under the authority granted by the Legislature. As authorized by the SFC, the issuance of bonds is administered by OST.

Consolidated cash flow financing. OST manages cash flow financing for multiple projects across multiple agencies in accordance with U.S. Treasury regulations to minimize administrative tax compliance monitoring over the life of the borrowing. Bond sales are sized to fund agency and OFM estimates of expected capital expenditures over a six-month period. In estimating cash flow needs, OST also considers remaining bond proceed balances and seasonal spending patterns. This type of cash flow financing ensures that funds are not borrowed until they are needed. Consolidating funding needs also produces pricing efficiencies in the sale of bonds, ensuring the state receives the lowest possible cost for all capital projects. It results in issuance amounts which meet the minimum size thresholds preferred by investors, and minimizes the costs of issuance such as underwriting, legal, and rating agency fees. Bond proceeds received on the closing date are immediately transferred to the appropriate funds as directed in the capital budget and by the bond authorizations.

25-year final maturities with level debt service. VPGO bonds are typically structured with level payments of principal and interest over a 25-year period. This serial amortization structure provides a disciplined repayment schedule which spreads the cost of the project over the life of the asset. It means that some of the bonds are repaid one year after issuance, some in the second year, some in the third year, and so forth each year until the last bonds are repaid in 25 years. In an interest rate environment with higher rates at longer maturities, serial amortization is also less expensive than repaying the debt at one maturity. The True Interest Cost (TIC) is the aggregate interest rate for the entire series based on the present value of the weighted average of the individual interest rates for each maturity. To meet the requirements of the federal Internal Revenue Code (the "Code"), the aggregate average life of projects funded with each series of bonds – that is, the assets being purchased or constructed – must exceed the aggregate average life of the bonds. For every series of bonds, OFM certifies that this requirement has been met.

Certificates of participation

The certificates of participation program uses standardized documentation, which minimizes legal and administrative costs for agencies. Once financing documents have been completed and borrowing rates set by the market, each agency receives a detailed schedule of semi-annual payments due on its outstanding leases. Funds are made available to agencies on a reimbursement basis upon the closing of the COP sale. Agencies must provide receipt of detailed invoices and proof of payment by the deadlines established by OST prior to the issuance of COPs. To ensure compliance with tax and legal requirements, OST periodically requests information to monitor the spend-down of proceeds and the use of the facilities that have been financed.

COP authorization Updated

The state is authorized by Chapter 39.94 RCW to enter into financing contracts for agencies to acquire real and personal property (real estate and equipment). Financing contracts are lease/ purchase contracts or capital leases with a term of more than one year, which provide that title to the property secures performance of the state, or transfer title to the property to the state by the end of the term. Each agency financing equipment or real estate under this program pledges its budget appropriation for payment of the lease. This is true regardless of whether it may anticipate making payments from other revenues.

The form of financing contracts is subject to approval by the SFC, which also approves the aggregate amount of financing contracts outstanding. The SFC guidelines for use of the program are shown in the Guidelines for Use of Financing Contracts on the . State law requires prior legislative approval of real estate financing contracts, typically in the capital budget. Most equipment financings do not require explicit legislative authorization, although OST policy requires legislative approval prior to financing major acquisitions of equipment or information systems.

Project financings. Unlike bonds, COP borrowings are "secured" financings, meaning investors have rights to the underlying property if investors are not repaid on a timely basis. For this reason, COP financings are for tangible assets that could be relinquished if the Legislature chooses not to appropriate funds for lease payments. Agencies must be able to offer a security interest in the asset being acquired and must commit to maintaining the property in working order and condition over the life of the borrowing. If a state agency cannot reasonably make these representations about the property to be financed, the property is not suitable for COP financing.

Borrowing term. The term of each financing contract must be greater than one year and no longer than the expected useful life of the asset being financed. Standardized guidance on the useful life of specific assets is available in SAAM, Chapter 30.50, Capital Asset Class and Location Code List and Useful Life Schedules. For unique or used equipment, OST staff can provide assistance. OST limits the maximum maturity to 25 years to efficiently pool multiple transactions in each COP issuance.

For administrative efficiency, OST has established a minimum borrowing threshold of $10,000 for each lease. Smaller financing requests for equipment of the same expected useful life can be combined.

Other financing contracts

Occasionally, the state finances construction projects with a 63-20 financing contract. In this structure, tax-exempt lease revenue bonds are issued by a non-profit corporation on behalf of the state. The non-profit corporation causes the project to be built through a fixed price contract with a private real estate development company. The state agency makes lease payments over time to a trustee and takes title to the property at the final maturity. Costs of issuance and ongoing fees on 63-20 financings are typically higher than on COP financings and the borrower usually pays higher interest rates. Use of a 63-20 financing contract requires legislative authorization. In addition, the SFC must approve both the financing contract and the non-profit corporation issuing the lease revenue bonds on behalf of the state.

For additional information, consult the SFC's Guidelines for the Use of 63-20 Financing Contracts on the .

4.5 Evaluating the appropriate funding source for bond- and COP-funded projects

For projects requested with bond funding, please consider these questions as you develop your request. For any project that answers any of questions 1 through 6 **and** question 7 with "yes," the projects may need to be fully or partially funded with taxable bonds or COPs. Similarly, for any project that answers questions 8 through 10 with "yes," the projects may need to be fully or partially funded with taxable bonds or COPs. For guidance, please see the "Private activity restrictions on tax-exempt financing" section above.

1. Will any portion of the project or asset ever be **owned** by any entity other than the state or one of its agencies or departments?
2. Will any portion of the project or asset ever be **leased** to any entity other than the state or one of its agencies or departments?
3. Will any portion of the project or asset ever be **managed or operated** by any entity other than the state or one of its agencies or departments?
4. Will any portion of the project or asset be used to perform **sponsored research** under an agreement with a nongovernmental entity*?
5. Does the project involve a **public/private venture**, **or** will any entity other than the state or one of its agencies or departments ever have a **special priority or other righ**t to use any portion of the project or asset to purchase or otherwise acquire any output of the project or asset such as electric power or water supply?
6. Will any portion of the bond/COP proceeds be **granted or transferred** to nongovernmental entities or granted or transferred to other governmental entities which will use the grant for nongovernmental purposes?
7. If you have answered **"Yes" to any of the questions above**, will your agency or any other state agency **receive any payments** from any nongovernmental entity, for the use of or in connection with, the project or asset?
8. Is any portion of the project or asset, or rights to any portion of the project or asset, expected to be **sold** to any entity other than the state or one of its agencies or departments?
9. Will any portion of the bond/COP proceeds be **loaned** to nongovernmental entities or loaned to other governmental entities that will use the loan for nongovernmental purposes?
10. Will any portion of the bond/COP proceeds be used for **staff costs for tasks not directly related** to a financed project(s)?