STATE FINANCE COMMITTEE

Guidelines for Use of 63-20 Financing Contracts

Overview of 63-20 Financing Structure Under the 63-20 structure, tax-exempt bonds are issued by a non-profit corporation on behalf of a public agency. The non-profit corporation causes the project to be designed and built, typically through a fixed-price contract with a private real estate development company. The real estate development company contracts with the architect and general contractor to deliver a building that meets the specifications set by the public agency.

- Security for the bonds is a stream of future rent payments from the state agency to the non-profit corporation under a lease agreement that includes express provisions that payment of state agency rent is subject to Executive Order reductions and legislative non-appropriation.

- Bonds issued with a 63-20 structure are not subject to the state's constitutional debt limit as they are issued by a non-profit corporation, not by the state. However, because of the state's lease obligation to the non-profit corporation, these obligations are reported on the state's CAFR and national credit rating agencies and municipal markets view 63-20 bonds as appropriation-backed obligations of the state.

- Title to the project is held by the non-profit for the life of the bonds. Title to the project is transferred to the public agency when the debt is repaid, i.e. at lease maturity when bonds issued by the non-profit corporation are retired.

- The project is used by the state agency for its governmental purposes under the lease, but the property may be operated and maintained either by the public agency or by the non-profit corporation through a management contract with a private management firm. However, IRS rules restrict the structure of any management contract.

- Costs of issuance and ongoing fees on 63-20 financings are significantly higher than those on conventional financings and the borrowing typically bears higher interest rates.

- At times, a 63-20 transaction may offer certain advantages to the public agency by allowing the agency to engage a private developer/manager who oversees the project, accepts certain construction risks and guarantees a fixed price. In some cases, the 63-20 structure can shorten the construction period and can reduce the risk of cost increases.

- While projects financed by 63-20 bonds are not considered public works under state law, the state has provided that prevailing wages be paid.

Specific Guidance

1. Cost-benefit analysis using Life Cycle Cost Models Should Demonstrate the Value of the 63-20 Structure. Before choosing 63-20 financing, an analysis using the Life Cycle Cost Model should demonstrate the advantages of the 63-20 approach versus other construction and financing alternatives. This cost-benefit analysis must establish that project benefits and operational efficiencies offset the increased credit risks, higher issuance costs and more expensive cost of funds typically associated with 63-20 financings.

2. Legal, Federal Tax and Operational Differences. Before choosing 63-20 financing, OST and the pertinent state agency should have a clear understanding of the legal, federal tax and operational advantages and disadvantages and other implications of 63-20 financing versus direct state financing, such as COP financing, as well as private developer project development versus the state's use of alternative contracting methods such as design-build or GCCM for project development.

3. Prior Legislative authorization should specify the financing amount. The successful use of appropriation-backed 63-20 financing requires legislative authorization that establishes clear legislative intent. That legislative authorization should describe the project purpose and scope and specify a not-to-exceed financing amount.

4. The Office of the State Treasurer has a key role in financial management. The successful outcome in a 63-20 financing depends on the efficiency, expertise, and coordination of the project management and finance management functions. Acting on behalf of the State Finance Committee, the Office of the State Treasurer should play a key role in financial management functions. Project management - including selection of the developer, development of the project design, scope price and schedule – is more appropriately handled by the state agency seeking the financing.

   Financial management includes the selection of the non-profit corporation, assembly of the financing team (financial advisor, legal team and the banking team) and management of the bond sale. Documents, legal provisions and disclosure materials should conform to the standards that are used for the State's COP and general obligation bonds to provide consistency and accuracy of information. All communication with rating agencies and investors must be centralized and coordinated by OST and disclosure standards must be consistent with those the State observes for all State related transactions. Similarly, OST will oversee the investment of all bond proceeds.

5. <u>Minimize Conflicts of Interest</u>. In most municipal transactions, the issuer is the obligor or the issuer is an authority of the actual governmental body responsible for paying debt service. In a 63-20 transaction, the issuer (a non-profit corporation without assets) has no organizational relationship with or fiduciary responsibility to the State and does not have ultimate, economic responsibility for the debt. It should be recognized that non-state parties in a 63-20 transaction may face conflicts of interest as they may only be compensated if the transaction is completed and they do not bear the ultimate responsibility for the debt. OST and the State Agency together should strongly represent the State's interests as distinct from the developer and non-profit conduit's interests