APPENDIX E
ALLOWABLE CAPITAL EXPENDITURE GUIDELINES

Introduction

State capital appropriations are funded primarily through the issuance of State bonds. State bonds must be authorized by Ohio voters via a Constitutional amendment and the interest on State bonds is generally exempt from federal and state income taxes (i.e., tax-exempt bonds). Thus, capital projects funded by State bonds must (1) fall within the authorized purposes for State bonded debt set forth in Article VIII of the Ohio Constitution and (2) meet federal tax law requirements for tax exempt bonds. These Allowable Capital Expenditure Guidelines are intended to assist State agencies in developing and implementing their capital plans and projects within these requirements.

Ohio Constitution -- Article VIII of the Ohio Constitution prohibits the State from incurring or assuming debt without a popular vote. To be eligible for bond funding in the State capital budget, a project must fall within the capital purposes authorized by the voters as set forth in the Ohio Constitution. Those purposes authorized in the Ohio Constitution include: highways; local government infrastructure; parks and recreation; natural resources and conservation; higher education facilities; elementary and second public school facilities; facilities to house branches and agencies of State government and their functions, including State office buildings and facilities; correction and juvenile detention facilities, mental health and development disabilities facilities; cultural, historical and sports facilities; and research and development (including coal research and development) and site development. Only projects that are within these purposes may be funded by State bonds authorized in the capital budget.

State Laws and Federal Tax Laws -- As further discussed in this guidance, the Ohio Revised Code and federal tax law also contain provisions that govern the allowable uses of bond proceeds for capital projects, including the types of projects and expenditures, and the extent to which non-governmental entities (both private for-profit and not-for-profit) can benefit from the project. State agencies should carefully review these allowable capital expenditure guidelines and work with OBM to ensure their projects are allowable under State and federal laws.

Appropriations for some purposes are not provided in the Capital Bill. For instance, debt-support appropriations for highway purposes are authorized in the biennial transportation budget. In addition, appropriations for some purposes are only made in the aggregate, and do not specify individual projects. For example, capital funding to support local government infrastructure is appropriated to the Public Works Commission where statute governs the project selection process.

Overview

The Ohio Revised Code and each bill containing new capital appropriations or reappropriations (the most recent being S.B. 310 of the 131th General Assembly) set forth the allowable uses of capital funds. Capital appropriations for buildings or structures, including remodeling and renovations, are limited to:

- Acquisition of real property or interests in real property (i.e., the purchase of land or easements).

- Buildings and structures, which includes construction, demolition, complete heating, lighting and lighting fixtures, as well as all necessary utilities, ventilating, plumbing, sprinkling, and sewer systems.
- Architectural, engineering, and professional services expenses directly related to the project (including feasibility studies).
- Machinery related to the operation or functioning of the building or structure at the time of its initial acquisition or construction.

In situations in which the State does not own the property on which the capital facility or improvement will be located, there are requirements that a higher education institution (with respect to Department of Higher Education capital projects) or a governmental agency (with respect to Mental Health and to Developmental Disabilities capital projects) own the property. This ownership requirement may be waived if:

(1) The higher education institution or governmental agency has a long-term lease, or other interest (such as an easement) in the property; or

(2) The Department of Higher Education on behalf of a higher education institution certifies to the Controlling Board that undue delay will occur if planning does not proceed while the property or property interest acquisition process continues. In this case, capital funds may be released upon approval by the Controlling Board to pay for planning through the development of schematic drawings only; or

(3) If the capital facilities will be owned or be part of facilities owned by a separate nonprofit organization and made available to a higher education institution or governmental agency for its use or benefit, the nonprofit organization either owns or has a long-term lease of the real property or other capital facility to be improved, renovated, constructed or acquired, and has entered into an agreement with the state agency or higher education institution that meets applicable statutory requirements.

Joint Use Agreements -- The Department of Higher Education has adopted rules (see OAC 3333-1-03(E)) regarding the release of moneys for capital projects not owned by the State or a higher education institution and the joint use of such projects. The joint use agreement, among other matters, must:

- Provide that the use of the funds and the process to be followed for expenditure of the funds is consistent with the capital appropriation language, the limitations on the use of capital appropriations as set forth in the capital bill, and any applicable state law and federal tax law limitations;
- Specify the extent and nature of the higher education institution's use or benefit of the project or improvement over a term of at least 20 years, with the value of that use or benefit to be reasonably related to the amount of the State capital appropriation.
- Provide for pro rata reimbursement to the State should the arrangement for joint use be terminated prior to the expiration of the 20-year term.
- Provide for payment or reimbursement to the higher education institution (not to exceed 1.5% of the appropriation) of its administrative costs incurred as a direct result of the project. The institution should document those reimbursed amounts by component.

Grant/Cooperative Use Agreements – Other State agencies that administer capital appropriations for projects owned or managed by governmental agencies or not-for profit entities must enter into an agreement with the entity receiving the State capital funding prior to release of those funds. Those agreements, among other matters, must:

- Provide that the use of the funds and the process to be followed for expenditure of the funds is consistent with the capital appropriation language, the limitations on the use of capital appropriations as set forth in the capital bill, and any applicable state law and federal tax law limitations;
- Specify the extent and nature of the State agency's use, right to use, or interest in the property over a period of 10 years or the term of the underlying State bonds, whichever is longer.
- Provide for pro rata reimbursement to the State should the arrangement for the State agency's use, right to use, or interest in the project be terminated prior to expiration of the term of the agreement.

Allowable Equipment and Furnishings

To be financed with capital funds, expenditures for equipment or furnishings that are part of a broader capital project or facility must meet all of the following criteria:

- Essential in bringing the facility up to its intended use or is necessary for the facility to function. The equipment or furnishing must be an integral part of or directly related to the basic purpose or function of the facility.
- Have a unit cost of $100 or more.
- Have a useful life of at least five years.
- Used primarily in the rooms or areas covered by the financed project.

Allowable equipment and furnishings would include computers and computer peripherals, workstations, lab and research equipment, desks, chairs, tables, bookshelves, file cabinets, carpeting/flooring, blinds, and curtains, provided that they satisfy all of the above criteria. An appropriation item specifically for equipment is allowable provided the equipment meets the above unit cost and useful life provisions.

Non-Allowable Equipment and Furnishings

- Not integral to the broader project or the facility's intended use.
- Motor vehicles used for basic transportation (e.g., cars, trucks, boats, off-road vehicles).
- General supplies and low-cost equipment (unit cost of less than $100).

In most cases, equipment or furnishings being purchased as part of a regular maintenance, upgrade or replacement effort is not appropriate for capital funding. Consumable supplies and low-cost equipment such as fuel, oil, adding machines, calculators, trash cans, common tools, paper stock, staplers, tape dispensers, etc. are not eligible uses of capital funds.

Maintenance/Repairs versus Renovations

- Maintenance and repairs, including maintenance contracts, are not eligible to be paid from capital funds and, thus, must be covered by operating funds.

- Maintenance includes a recurring activity necessary to maintain the operation, functionality, appearance, or safety of a piece of equipment, building or structure. Repairs are maintenance projects that fix a problem but do not extend the useful life of an asset.
- Maintenance and repairs generally include any project with the objective of returning or restoring an item back to its original intended use or state.
- Examples of maintenance and repairs include: fixing a part or component of the heating or cooling system, fixing a leaky pipe, patching a wall, repainting, sealing windows or floors, mold remediation, replacing sections of flooring or ceiling tiles, and glass replacement, resetting exterior walkways, replacing roofing shingles to fix a leak, and fixing tables or chairs.
- Renovations are more extensive enhancements, upgrades, or replacements of buildings or structures or systems and are an appropriate use of capital funds. Examples include replacing an essential component of the heating or cooling system such that the useful life of the system is extended, renovations of classrooms or other space into computer or research laboratories, upgrading electrical equipment or plumbing system components, replacing a roof, demolition, replacing carpet, painting as part of new construction or a renovation, upgrading a building's security or automation system, and replacing stairs or walkways to meet ADA standards.

Leases, Lease-Purchase, and Installment Purchases

- Leases and lease-purchases of vehicles or equipment are <u>not</u> allowable capital expenditures.
- Installment purchases while not strictly prohibited are generally not approved as allowable capital expenditures.

INFORMATION TECHNOLOGY (IT) SYSTEM PROJECTS

Capital funds may be used to support the acquisition, development, deployment, or integration (including project management) of information technology systems that constitute or are an integral part of approved capital projects. Capital funds may not be used to support the ongoing operation and maintenance of such projects.

<u>ALLOWABLE</u>

Hardware

Capital funds may be used to purchase computers (including personal computers) and related peripherals such as servers, mainframes, printers, scanners, fax machines, etc.

Software

- Software development and design (akin to facility design and engineering).
- Purchases of packaged "off-the-shelf" software are allowable if they have an expected useful life of at least five years and meet one of the following criteria:
  - Related to the initial deployment of an agency or university-wide system or other major project deployment (periodic upgrades must be purchased with operating funds); or
  - When necessary to bring a newly constructed facility or an allowable piece of equipment up to its intended use (e.g. a computer lab).

- Software licenses with a term of at least five years.
- Purchase of perpetual licenses enabling the acquisition of shared electronic resources and databases.

Personnel Expenses

Capital funds may be used to support personnel costs related to the initial development and deployment of an information technology project. Employees splitting time between the new information technology project and other work or only temporarily assigned to the IT project should continue to be funded out of operating funds.

NON-ALLOWABLE

Training and Maintenance

Expenses related to training of personnel on the new IT system or any of its components is generally not an allowable capital expenditure. Additionally, operating, not capital, funds must be used to support the ongoing maintenance and operation of IT systems or other regular, recurring expenses.

Software

Capital funds generally may not be used to purchase standard off-the-shelf software (such as MS Office software, Adobe, and web browsers) or any software package with individual license costs under $500. Additionally, capital funds may not be used to purchase software upgrades.

Personnel Expenses

Capital funds may be used to cover only those labor expenses directly related to the initial development and deployment of a capital project. They may not be used to fund ongoing maintenance and operational expenses of a project once it is developed. In the case of colleges and universities, capital funds may not be used to cover tuition reimbursement or graduate assistantships.

Follow-Up Questions Regarding Proposed Expenditures

- Questions regarding the capital funding eligibility of proposed expenditures should be directed to the agency's operating and capital analysts at the Office of Budget and Management.
- Institutions of higher education should consult with the capital planning Director of the Department of Higher Education.