OFFICE OF BUDGET AND MANAGEMENT ALLOWABLE CAPITAL EXPENDITURE GUIDELINES

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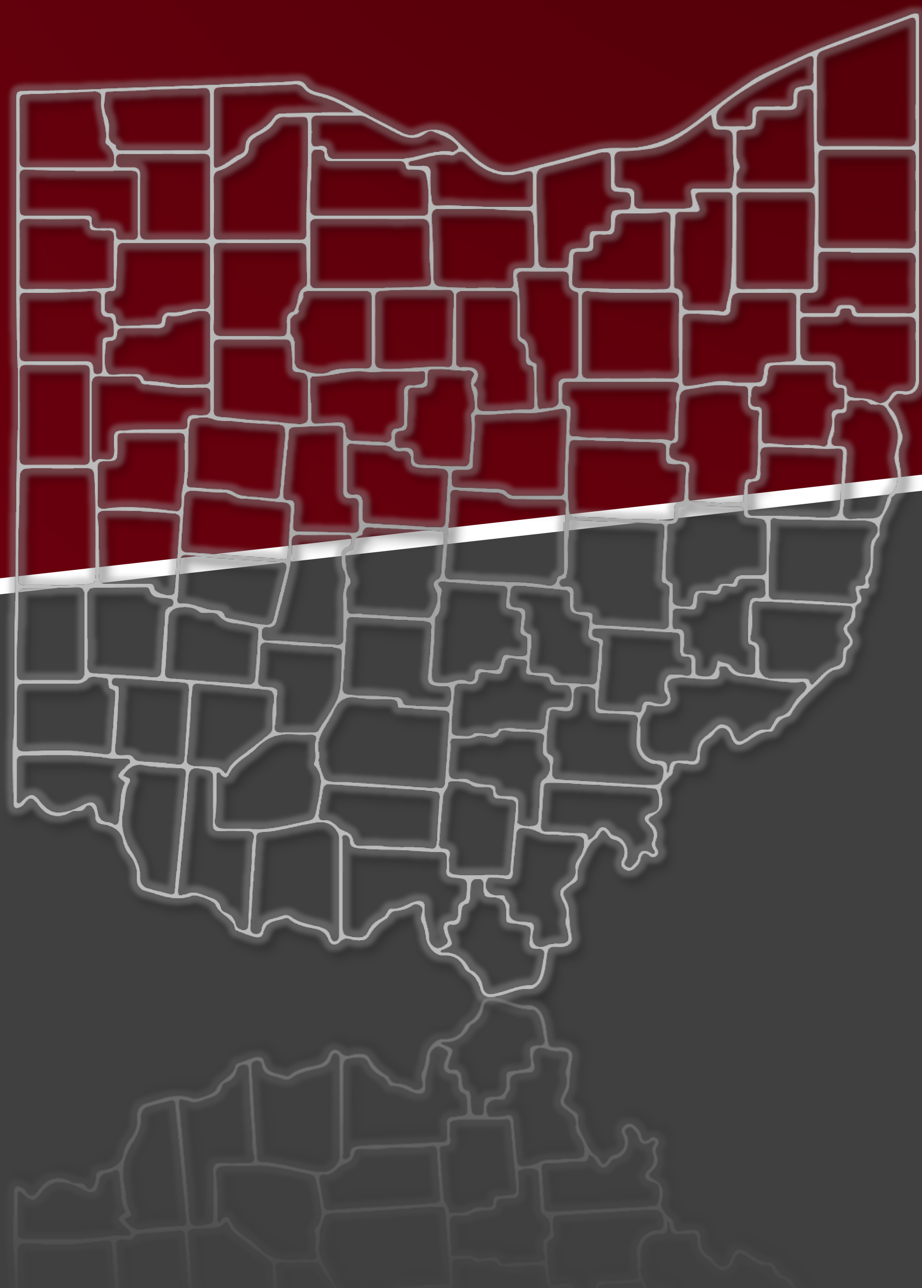

Ohio | Office of Budget and Management

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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 secondary 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.

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 nongovernmental 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.

Not all appropriations for capital projects/purposes are provided for via a capital bill. For instance, debt-supported appropriations for highway purposes are authorized in the biennial transportation budget. In addition, appropriations for some purposes are made only in the aggregate and, thus, do not specify individual projects. For example, capital funding to support local government infrastructure is appropriated to the Public Works Commission whereas the Ohio Revised Code governs the project selection process.

Overview

The Ohio Revised Code and each bill containing new capital appropriations (most recently H.B. 687 of the 134th General Assembly) or reappropriations (most recently H.B. 597 of the 134th 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 and cooling, lighting, and lighting fixtures, as well as all necessary utilities, ventilating, plumbing, sprinkling, and water/sewer systems, when such systems are authorized or necessary.
- Architectural, engineering, and professional services expenses directly related to the project (including feasibility studies).
- Machinery necessary to the operation or function of the building or structure at the time that it is acquired or constructed.
- Acquisition, development, and deployment of new computer systems, including the integration of existing and new computer systems, but excluding regular or ongoing maintenance or support agreements.
- Furniture, fixtures, or equipment meeting the criteria discussed below.

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 state agency, as defined in R.C. 154.01, own the property. This ownership requirement may be waived if:

- The higher education institution or state agency has a long-term lease, or other interest (such as an easement) in the property; or
- With respect to institutions of higher education, the Department of Higher Education, on behalf of the 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
- If the capital facilities will be owned by, or be part of facilities owned by, a separate nonprofit organization or public body and made available to a higher education institution or state 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 (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 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 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 or benefit, or right to use, or interest in the project or improvement for a term not shorter than the length of the obligations that financed the project or improvement.
- 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:

- Is essential in bringing the facility up to its intended use or is necessary for the facility to function. Not only must the equipment or furnishing be an integral part of or directly related to the basic purpose or function of the facility, but it must also be used primarily in the rooms or areas covered by the financed project.
- Have a unit cost of about $100 or more.
- Have a useful life of at least five years.

Allowable equipment and furnishings 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, calculators, trash cans, 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 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, glass replacement, resetting exterior walkways, replacing roofing shingles to fix a leak, and brick mortar repair/patching (tuckpointing).
- Conversely, 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, replacing exterior windows, new carpet, painting as part of new construction or a renovation, upgrading a building's security or automation system, replacing stairs or walkways to meet ADA standards, and total brick mortar replacement (repointing).

Leases, Lease-Purchase, and Installment Purchases

- Leases of vehicles or equipment, including leases with an option to purchase, are not allowable capital expenditures.
- Installment purchases, while not strictly prohibited, are generally not approved as allowable capital expenditures.

Information Technology System Projects

Capital funds may be used to support the application development, deployment, and integration (including project management) of information technology (IT) systems that constitute or are a part of a larger capital project. Capital funds may not be used to support the ongoing operation and maintenance of such project.

Allowable

Allowable capital IT project expenditures include systems developed for internal use that have a useful life of five or more years. Allowable costs generally include the design, configuration, and deployment of IT systems along with customized software and its licensing, interfaces, data conversion, and various other hardware and peripherals. State agencies and higher education institutions should only consider an IT project as a potential capital expenditure when the cost of application development meets or exceeds $10 million. For new and replacement systems, capital expenditures usually occur after the preliminary project phase is completed and when management has authorized funding of the project.

IT system upgrades may also be considered an allowable capital expenditure when they add significant functionality or are necessary to postpone obsolescence. State agencies and higher education institutions should ensure that postponing obsolescence is generated by the upgrade and not simply by ongoing maintenance or the maintenance component of the upgrade. For example, a system upgrade that included technical upgrades, security enhancements, and significant additions of functionality would be considered an allowable capital expenditure, while an upgrade that included only routine technical and/or security improvements would be an appropriate operating expenditure.

Hardware -- Capital funds may be used to purchase hardware for IT systems and its components, including but not limited to servers, network equipment, desktops/laptops, monitors, printers, scanners, etc.

Software, Licensing, and Warranties

- Purchases of packaged “off-the-shelf” software are allowable if they have an expected useful life of at least five years and have been tailored or customized to the IT project. The software purchase must also 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).
- Application development, configuration, or deployment.
- Software licenses for commercial off-the-shelf products with a term of at least five years, provided the cost is paid for upfront as part of the development stage.
- Software licenses for cloud-based products related to application build, provided the state agency or higher education institution has a contractual right to take possession of the software and it is feasible to run the software on its own hardware.
- Data conversions required to make the new IT system operational.
- Purchase of perpetual licenses enabling the acquisition of shared electronic resources and databases.
- Warranties purchased at the time of initial acquisition with a term of at least five years and provided that the terms and conditions are substantially the same as warranties available to other purchasers.

Non-Allowable

Operation and Maintenance -- Operating funds must be used to support the ongoing operation and maintenance of IT systems and other regular, recurring expenses.

Replacement Hardware -- Capital funds generally may not be used to purchase end of life or replacement hardware equipment (computers, peripherals, etc.) that do not upgrade or add functionality to an IT system.

Software and Licensing -- 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 periodic software upgrades, minor upgrades and patches, minor configurations, or security enhancements. Software licenses for premise-based and cloud-based products post-implementation, including annual licensing and subscription-based software, should also be paid from operating funds.

Planning and Post-Implementation -- Capital funds generally may not be used to cover costs associated with planning or post-implementation operation of an IT project, including project-related research and planning, service management and strategic planning, post-implementation activities including project and change management, and data conversions that are not required for an IT system to be operational. Additionally, costs associated with the solicitation, review, and selection of professional service providers or vendors, including contract development, should be paid from operating funds.

Personnel Expenses -- Capital funds generally may not be used to cover expenses of state employees working on IT projects. Employees working on IT projects should continue to be funded out of operating funds. In the case of colleges and universities, capital funds may not be used to cover tuition reimbursement or graduate assistantships. (Note, although federal tax law does allow for state personnel expenses under certain circumstances, the extensive and detailed record-keeping requirements necessary to comply with IRS audits generally offset any potential benefit).

Training -- Expenses related to training of personnel on the new IT system or any of its components is generally not an allowable capital expenditure. Some expenses related to the initial deployment of the IT system (e.g., creating the system user manual) may be allowable.

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.