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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

July 24, 2019

FINANCE MEMORANDUM

MEMO NO. 19-09

TO: All Department Heads

FROM: Neal H. Miyahira /S/
Director of Finance

SUBJECT: General Obligation Tax-Exempt Bonds
Private Use of Bond Proceeds and Bond-Financed Facilities
Public-Private Partnership Arrangements and Other Transactions

The Department of Budget & Finance wishes to remind all departments and agencies of the State of Hawaii (State) that the federal tax law imposes restrictions on the private use of the proceeds of tax-exempt General Obligation (G.O.) bonds and on the capital improvement projects financed with such proceeds. Tax-exempt G.O. Bonds are typically used to finance capital improvement projects throughout the State. Appropriations for these projects are funded by the State through the issuance of tax-exempt G.O. Bonds.

Failure to comply with federal rules on the private use of bond proceeds and bond-financed property could jeopardize the tax-exempt status of the G.O. Bonds, resulting in significant adverse consequences to bondholders or forcing the State to incur costly measures to remediate the tax law violations. Accordingly, B&F would like to ensure that all departments and agencies use their tax-exempt G.O. Bond appropriations and the property financed thereby in a manner complying with the private use rules.

Please be advised that the following transactions with private entities, including for-profit or non-profit organizations, individuals, and the federal government or any of its agencies (collectively, "nongovernmental persons") are subject to the private use restrictions: (i) the direct or indirect loan of tax-exempt G.O. Bond proceeds, (ii) the sale of bond-financed property, (iii) the lease or license of bond-financed property (other than leases with a term, inclusive of renewal options, not exceeding 50 days that are negotiated at arm's length for fair market value compensation) and (iv) contracts for the management or operation of bond-financed property that do not satisfy certain IRS guidelines. Other specialized situations that may involve private use include contracts for the purchase of output (e.g. an electric plant or a water facility) and contracts for research sponsored by a private entity or a federal agency.

Please be aware that public-private partnership arrangements ("P3s") that transfer operation, control or use of bond-financed property to a nongovernmental person must comply with the private use restrictions.

In addition to the short-term leases described in clause (iii) of the third paragraph above, certain contracts with nongovernmental persons are not treated as private use: contracts for services incidental to the primary function of the bond-financed facility (e.g., janitorial, office equipment repair, billing) and contracts involving incidental use of a bond-financed facility (e.g., vending machines, advertising displays, uses not involving the transfer of possession and control of separate space) provided all incidental uses at a facility do not exceed 2.5% of the facility and are not related to other use of the facility by the same user or users.

The IRS rules on private use are complex and subject to varying interpretation, and often their application turns on the facts of the particular case. Departments and agencies encountering a proposal for the private use of G.O. Bond proceeds or the capital improvements financed with such proceeds, should contact B&F regarding the particulars of the proposal.

In addition to the federal rules, please be advised that Section 39-14 (b), Hawaii Revised Statutes, requires that "... no state officer or employee, or user of a project or program shall authorize or allow any change, amendment, or modification to a project or program financed or refinanced with the proceeds of the bonds which change, amendment, or modification thereto would affect the exclusion of interest on the bonds from gross income for federal income tax purposes unless the change, amendment, or modification shall have received the prior approval of the director of finance. Failure to receive the approval of the director of finance shall render any change, amendment, or modification void."

Should you have any questions, your staff may call Mr. Roderick Becker, Administrator, Financial Administration Division, at 586-1612.