GEORGIA STATE FINANCING AND INVESTMENT COMMISSION
(GSFIC)
Policy and Procedures, Owner
Commission

Policy Title/Number
Public Private Partnership
CO-01-01-001

Effective Date: August 4, 2004
Revises Previous Effective Date:

References:
Constitution of the State of Georgia, as amended - Section IV
O.C.G.A. §50-17-22 et seq.
Internal Revenue Code of 1986, as amended
Internal Revenue Code Summary dated June 16, 2004, authored by King
and Spalding
Attorney General Memorandum - February 1998
Research/Opinions dated April 22, 2004 authored by King and Spalding

1. Introduction

When the State of Georgia issues general obligation bonds, it has historically
done so on a tax-exempt basis under the Internal Revenue Code of 1986, as
amended (the "Internal Revenue Code"). The issuance of general obligation
bonds on a tax-exempt basis by the State allows the State to achieve the lowest
possible interest cost since the interest on the bonds is excludable from the gross
income of the purchasers of the bonds. In order to protect the tax-exemption of
the State's general obligation bonds, compliance with covenants which the State
makes in connection with the issuance of its general obligation bonds regarding
the operation and use of the facilities by Departments, Agencies, or Authorities of
the State financed in whole or in part with tax-exempt general obligation bond
proceeds are of vital interest to the State.

2. Applicability

State Departments, Agencies, and Authorities

3. Policy Statement

The Georgia State Financing and Investment Commission is aware that
Departments, Agencies, and Authorities of the State in developing their capital
financing plans often consider the operation or use of these facilities by non-
governmental entities or persons in varying degrees. These are often referred to
as public/private partnerships or privatization. The Georgia State Financing and
Investment Commission has to be involved in the early planning process for such
public/private partnerships in that to the extent such endeavors involve the use of
State general obligation bond proceeds, there are certain limits imposed by the
Internal Revenue Code which have to be met in order to protect the tax-exempt
status of the interest on the State's general obligation bonds.
4. Definitions

*Private Activity Bond:* the Internal Revenue Code, as amended defines this as any bond that satisfies the "private business use test" and the "private security or payment test".

Private Activity Examples:
- outright transfer of ownership;
- leases;
- management contracts;
- output contracts;
- research agreements;
- any other arrangements that convey special legal entitlements for beneficial use of bond proceeds or financed property that are comparable to those under any of the arrangements listed above.

*Private Business Use Test:* (private business use) if more than 10% of the proceeds of the issue are to be used in the trade or business of any person other than a government unit.

*Private Security or Payment Test:* (private business use) if more than 10% of the payment of principal of or interest on the issue is, directly or indirectly, secured by property used in trade or business, or derived from such.

*General Obligation Debt:* as written in the Constitution of the State of Georgia Section IV State Debt; (c) "to acquire, construct, develop, extend, enlarge, or improve land, waters, properties, highways, buildings, structures, equipment, or facilities of the State..." (d) "... to provide educational facilities for county and independent school system and to provide public library facilities for county and independent school systems, counties, municipalities, and boards of trustees of public libraries or boards of trustees of public library systems..." (e) "in order to make loans to counties, municipal corporations, political subdivisions, local authorities, and other local governmental entities for water, or sewage facilities or systems..."

*Private Debt:* not limited to Department, Agency, or Authority bank loans, guaranteed lines of credit, notes, revenue bonds, Federal bonds.

*Cash:* not limited to budgetary monies, grant monies, or donations.

5. Procedure

The Georgia State Financing and Investment Commission hereby directs that all Departments, Agencies, and Authorities of the State who are developing capital plans which may be financed, in whole or part, with the proceeds of State general obligation bond proceeds, prior to the approval of any such capital plans by the Departments, Agencies, and Authorities or the execution of any contracts relating to such facilities by such Departments, Agencies, and Authorities submit to the Director's of the Georgia State Financing and Investment Commission, the following:
(a) A statement of the type of project being considered;
(b) The nature of any operation or use by non-governmental entities or individuals;
(c) Any proposed leases and management or use contracts with non-governmental entities or individuals;
(d) Any proposed research agreements with any non-governmental entities or individuals; and
(e) An organizational chart of the financing structure proposed, the ownership relationships and the operation and maintenance relationships to the recipient of the general obligation proceeds

The Georgia State Financing and Investment Commission will manage, administer, or oversee all public/private partnership in which general obligation proceeds are utilized in order to assure that all constitutional and statutory responsibilities charged to the Commission are met.

The Director of the Construction Division of the Georgia State Financing and Investment Commission is solely responsible for the assignment of project management. Any delegation of responsibilities will be at the discretion of the Director of the Construction Division, and will be authorized in writing.

**GSFIC Evaluation**

The Georgia State Financing and Investment Commission upon receipt of the information specified in the Procedures Section above will proceed as follows:

(a) The Georgia State Financing and Investment Commission will identify whether there is any concern that needs to be addressed in order to protect the tax-exempt nature of the interest on State of Georgia general obligation bonds.

(b) The Georgia State Financing and Investment Commission, with the advice and counsel of the Department of Law, will evaluate all leases, management or use contracts and research agreements to insure that they comply with the safe havens set forth in Internal Revenue Service Regulations and Revenue Procedures. If the lease, management or use contract, or research agreement does not comply, the lease, management or use contract, or research agreement shall be modified to comply with Internal Revenue Service Regulations and Revenue Procedures prior to the department or agency’s entering into any lease, management or use contract or research agreement with respect to facilities to be financed in whole or in part with the proceeds of State of Georgia tax-exempt general obligation bond proceeds.
Compliance Methods

Sometimes the concern regarding the operation or use of the facilities in which State of Georgia tax-exempt general obligation bond proceeds are to be used can be addressed (a) by an allocation of bond proceeds to the portions of the facilities [the State of Georgia has chosen a square footage allocation method] which will have 100% governmental use only and with non-bond proceeds being used to finance the portions of the facilities which will be operated or used by non-governmental entities or individuals; or (b) by use of management and service agreements or research agreements which meet the requirements of the Internal Revenue Code such that the benefits of the tax-exempt financing inure only to governmental bodies. The Georgia State Financing and Investment Commission will consider these alternatives in its review of proposed uses of tax-exempt general obligation bond proceeds.

Reservation for Non-Governmental Use

Since facilities for many Departments, Agencies, and Authorities are often bundled together in a given series of State general obligation bonds, no Department, Agency, or Authority shall decide on its own with its own advisors that any use by a non-governmental entity or person can be permitted because it is within the 10%, non-governmental use, exception, (sometimes called the "bad money" exception). The "bad money" exception is reserved solely to the Georgia State Financing and Investment Commission in that (a) only the Georgia State Financing and Investment Commission has knowledge of all of the facilities financed with the proceeds of any given bond issue and (b) the Georgia State Financing and Investment Commission hereby reserves such bad money portion to provide a safety factor in the event that facilities financed with the proceeds of State of Georgia general obligation bonds are used for unintended or non-permitted purposes contrary to the representations made by a Department, Agency, or Authority of the State when they receive such monies or to solve "change of use" of facilities which occur after the facilities are built. No State Department, Agency, or Authority shall make capital plans depending upon a "bad money" analysis or enter into any contracts for any facilities in which the proceeds of State of Georgia tax-exempt bond proceeds are to be used depending upon any such "bad money" analysis without the specific written approval from the Director's of the Georgia State Financing and Investment Commission.

Remedial Action

If after all of the safe guards above set forth are utilized and in order to protect the tax-exemption of outstanding State of Georgia general obligation bonds, the Georgia State Financing and Investment Commission determines that any Department, Agency, or Authority has failed to use bond proceeds in accordance with the representations set forth in its request resolution for tax-exempt State of Georgia general obligation bond proceeds, notification will be made to the Commission members of the Georgia State Financing and Investment Commission for further review and action.
6. Attachments

Reference Material 1: Constitution of the State of Georgia, as amended - Section IV
Reference Material 3: Internal Revenue Code of 1986, as amended
Reference Material 5: Research/Opinions dated April 22, 2004 authored by King and Spalding

7. Record Retention

Non-Applicable
Public Private Partnership Policy
Reference Documents
State of Georgia Constitution

SECTION IV.

STATE DEBT

Paragraph I. Purposes for which debt may be incurred.

The state may incur:

(a) Public debt without limit to repel invasion, suppress insurrection, and defend the state in time of war.

(b) Public debt to supply a temporary deficit in the state treasury in any fiscal year created by a delay in collecting the taxes of that year. Such debt shall not exceed, in the aggregate, 5 percent of the total revenue receipts, less-refunds, of the state treasury in the fiscal year immediately preceding the year in which such debt is incurred. The debt incurred shall be repaid on or before the last day of the fiscal year in which it is incurred out of taxes levied for that fiscal year. No such debt may be incurred in any fiscal year under the provisions of this subparagraph (b) if there is then outstanding unpaid debt from any previous fiscal year which was incurred to supply a temporary deficit in the state treasury.

(c) General obligation debt to acquire, construct, develop, extend, enlarge, or improve land, waters, property, highways, buildings, structures, equipment, or facilities of the state, its agencies, departments, institutions, and of those state authorities which were created and activated prior to November 8, 1960.

(d) General obligation debt to provide educational facilities for county and independent school systems and to provide public library facilities for county and independent school systems, counties, municipalities, and boards of trustees of public libraries or boards of trustees of public library systems, and, when the construction of such educational or library facilities has been completed, the title to such facilities shall be vested in the respective local boards of education, counties, municipalities, or public library boards of trustees for which such facilities were constructed.

(e) General obligation debt in order to make loans to counties, municipal corporations, political subdivisions, local authorities, and other local government entities for water or sewerage facilities or systems or for regional or multijurisdictional solid waste recycling or solid waste facilities or systems. It shall not be necessary for the state or a state authority to hold title to or otherwise be the owner of such facilities or systems. General obligation debt for these purposes may be authorized and incurred for administration and disbursement by a state authority created and activated before, on, or after November 8, 1960.

(f) Guaranteed revenue debt by guaranteeing the payment of revenue obligations issued by an instrumentality of the state if such revenue obligations are issued to finance:

(1) Toll bridges or toll roads.

(2) Land public transportation facilities or systems.
(3) Water facilities or systems.
(4) Sewage facilities or systems.
(5) Loans to, and loan programs for, citizens of the state for educational purposes.
(6) Regional or multijurisdictional solid waste recycling or solid waste facilities or systems.

Paragraph II. State general obligation debt and guaranteed revenue debt; limitations.

(a) As used in this Paragraph and Paragraph III of this section, "annual debt service requirements" means the total principal and interest coming due in any state fiscal year. With regard to any issue of debt incurred wholly or in part on a term basis, "annual debt service requirements" means an amount equal to the total principal and interest payments required to retire such issue in full divided by the number of years from its issue date to its maturity date.

(b) No debt may be incurred under subparagraphs (c), (d), and (e) of Paragraph I of this section or Paragraph V of this section at any time when the highest aggregate annual debt service requirements for the then current year or any subsequent year for outstanding general obligation debt and guaranteed revenue debt, including the proposed debt, and the highest aggregate annual payments for the then current year or any subsequent fiscal year of the state under all contracts then in force to which the provisions of the second paragraph of Article IX, Section VI, Paragraph I(a) of the Constitution of 1976 are applicable, exceed 10 percent of the total revenue receipts, less refunds of the state treasury in the fiscal year immediately preceding the year in which any such debt is to be incurred.

(c) No debt may be incurred under subparagraphs (c) and (d) of Paragraph I of this section at any time when the term of the debt is in excess of 25 years.

(d) No guaranteed revenue debt may be incurred to finance water or sewage treatment facilities or systems when the highest aggregate annual debt service requirements for the then current year or any subsequent fiscal year of the state for outstanding or proposed guaranteed revenue debt for water facilities or systems or sewage facilities or systems exceed 1 percent of the total revenue receipts less refunds, of the state treasury in the fiscal year immediately preceding the year in which any such debt is to be incurred.

(e) The aggregate amount of guaranteed revenue debt incurred to make loans for educational purposes that may be outstanding at any time shall not exceed $18 million, and the aggregate amount of guaranteed revenue debt incurred to purchase, or to lend or deposit against the security of, loans for educational purposes that may be outstanding at any time shall not exceed $72 million.

Paragraph III. State general obligation debt and guaranteed revenue debt; conditions upon issuance; sinking funds and reserve funds.
(a)(1) General obligation debt may not be incurred until legislation is enacted stating the purposes, in general or specific terms, for which such issue of debt is to be incurred, specifying the maximum principal amount of such issue and appropriating an amount at least sufficient to pay the highest annual debt service requirements for such issue. All such appropriations for debt service purposes shall not lapse for any reason and shall continue in effect until the debt for which such appropriation was authorized shall have been incurred, but the General Assembly may repeal any such appropriation at any time prior to the incurring of such debt. The General Assembly shall raise by taxation and appropriate each fiscal year, in addition to the sum necessary to make all payments required under contracts entitled to the protection of the second paragraph of Paragraph I (a), Section VI, Article IX of the Constitution of 1976, such amounts as are necessary to pay debt service requirements in such fiscal year on all general obligation debt.

(2)(A) The General Assembly shall appropriate to a special trust fund to be designated "State of Georgia General Obligation Debt Sinking Fund" such amounts as are necessary to pay annual debt service requirements on all general obligation debt. The sinking fund shall be used solely for the retirement of general obligation debt payable from the fund. If for any reason the monies in the sinking fund are insufficient to make, when due, all payments required with respect to such general obligation debt, the first revenues thereafter received in the general fund of the state shall be set aside by the appropriate state fiscal officer to the extent necessary to cure the deficiency and shall be deposited by the fiscal officer into the sinking fund. The appropriate state fiscal officer may be required to set aside and apply such revenues at the suit of any holder of any general obligation debt incurred under this section.

(B) The obligation to make sinking fund deposits as provided in subparagraph (2)(A) shall be subordinate to the obligation imposed upon the fiscal officers of the state pursuant to the provisions of the second paragraph of Paragraph I (a) of Section VI of Article IX of the Constitution of 1976.

(b)(1) Guaranteed revenue debt may not be incurred until legislation has been enacted authorizing the guarantee of the specific issue of revenue obligations then proposed, reciting that the General Assembly has determined such obligations will be self-liquidating over the life of the issue (which determination shall be conclusive), specifying the maximum principal amount of such issue and appropriating an amount at least equal to the highest annual debt service requirements for such issue.

(2)(A) Each appropriation made for the purposes of subparagraph (b)(1) shall be paid upon the issuance of said obligations into a special trust fund to be designated "State of Georgia Guaranteed Revenue Debt Common Reserve Fund" to be held together with all other sums similarly appropriated as a common reserve for any payments which may be required by virtue of any guarantee entered into in connection with any issue of guaranteed revenue obligations. No appropriations for the benefit of guaranteed revenue debt shall lapse unless repealed prior to the payment of the appropriation into the common reserve fund.
(B) If any payments are required to be made from the common reserve fund to meet debt service requirements on guaranteed revenue obligations by virtue of an insufficiency of revenues, the amount necessary to cure the deficiency shall be paid from the common reserve fund by the appropriate state fiscal officer. Upon any such payment, the common reserve fund shall be reimbursed from the general funds of the state within ten days following the commencement of any fiscal year of the state for any amounts so paid; provided, however, the obligation to make any such reimbursements shall be subordinate to the obligation imposed upon the fiscal officers of the state pursuant to the second paragraph of Paragraph I (a) of Section VI, Article IX of the Constitution of 1976 and shall also be subordinate to the obligation to make sinking fund deposits for the benefit of general obligation debt. The appropriate state fiscal officer may be required to apply such funds as provided in this subparagraph (b)(2)(B) at the suit of any holder of any such guaranteed revenue obligations.

(C) The amount to the credit of the common reserve fund shall at all times be at least equal to the aggregate highest annual debt service requirements on all outstanding guaranteed revenue obligations entitled to the benefit of the fund. If at the end of any fiscal year of the state the fund is in excess of the required amount, the appropriate state fiscal officer, as designated by law, shall transfer the excess amount to the general funds of the state free of said trust.

(c) The funds in the general obligation debt sinking fund and the guaranteed revenue debt common reserve fund shall be as fully invested as is practicable, consistent with the requirements to make current principal and interest payments. Any such investments shall be restricted to obligations constituting direct and general obligations of the United States government or obligations unconditionally guaranteed as to the payment of principal and interest by the United States government, maturing no longer than 12 months from date of purchase.

Paragraph IV. Certain contracts prohibited.

The state, and all state institutions, departments and agencies of the state are prohibited from entering into any contract, except contracts pertaining to guaranteed revenue debt, with any public agency, public corporation, authority, or similar entity if such contract is intended to constitute security for bonds or other obligations issued by any such public agency, public corporation, or authority and, in the event any contract between the state, or any state institution, department or agency of the state and any public agency, public corporation, authority or similar entity, or any revenues from any such contract, is pledged or assigned as security for the repayment of bonds or other obligations, then and in either such event, the appropriation or expenditure of any funds of the state for the payment of obligations under any such contract shall likewise be prohibited.

Paragraph V. Refunding of debt.
The state may incur general obligation debt or guaranteed revenue debt to fund or refund any such debt or to fund or refund any obligations issued upon the security of contracts to which the provisions of the second paragraph of Paragraph I(a), Section VI, Article IX of the Constitution of 1976 are applicable. The issuance of any such debt for the purposes of said funding or refunding shall be subject to the 10 percent limitation in Paragraph II(b) of this section to the same extent as debt incurred under Paragraph I of this section; provided, however, in making such computation the annual debt service requirements and annual contract payments remaining on the debt or obligations being funded or refunded shall not be taken into account. The issuance of such debt may be accomplished by resolution of the Georgia State Financing and Investment Commission without any action on the part of the General Assembly and any appropriation made or required to be made with respect to the debt or obligation being funded or refunded shall immediately attach and inure to the benefit of the obligations to be issued in connection with such funding or refunding. Debt incurred in connection with any such funding or refunding shall be the same as that originally authorized by the General Assembly, except that general obligation debt may be incurred to fund or refund obligations issued upon the security of contracts to which the provisions of the second paragraph of Paragraph I(a), Section VI, Article IX of the Constitution of 1976 are applicable and the continuing appropriations required to be made under this Constitution shall immediately attach and inure to the benefit of the obligation to be issued in connection with such funding or refunding with the same force and effect as though said obligations so funded or refunded had originally been issued as a general obligation debt authorized hereunder. The term of a funding or refunding issue pursuant to this Paragraph shall not extend beyond the term of the original debt or obligation and the total interest on the funding or refunding issue shall not exceed the total interest to be paid on such original debt or obligation. The principal amount of any debt issued in connection with such funding or refunding may exceed the principal amount being funded or refunded to the extent necessary to provide for the payment of any premium thereby incurred.

Paragraph VI. *Faith and credit of state pledged debt may be validated.*

The full faith, credit, and taxing power of the state are hereby pledged to the payment of all public debt incurred under this article and all such debt and the interest on the debt shall be exempt from taxation. Such debt may be validated by judicial proceedings in the manner provided by law. Such validation shall be incontestable and conclusive.

Paragraph VII. *Georgia State Financing and Investment Commission; duties.*

(a) There shall be a Georgia State Financing and Investment Commission. The commission shall consist of the Governor, the President of the Senate, the Speaker of the House of Representatives, the State Auditor, the Attorney
General, the director, Fiscal Division, Department of Administrative Services, or such other officer as may be designated by law, and the Commissioner of Agriculture. The commission shall be responsible for the issuance of all public debt and for the proper application, as provided by law, of the proceeds of such debt to the purposes for which it is incurred; provided, however, the proceeds from guaranteed revenue obligations shall be paid to the issuer thereof and such proceeds and the application thereof shall be the responsibility of such issuer. Debt to be incurred at the same time for more than one purpose may be combined in one issue without stating the purpose separately but the proceeds thereof must be allocated, disbursed and used solely in accordance with the original purpose and without exceeding the principal amount authorized for each purpose set forth in the authorization of the General Assembly and to the extent not so used shall be used to purchase and retire public debt. The commission shall be responsible for the investment of all proceeds to be administered by it and, as provided by law, the income earned on any such investments may be used to pay operating expenses of the commission or placed in a common debt retirement fund and used to purchase and retire any public debt, or any bonds or obligations issued by any public agency, public corporation or authority which are secured by a contract to which the provisions of the second paragraph of Paragraph I(a) of Section VI, Article IX of the Constitution of 1976 are applicable. The commission shall have such additional responsibilities, powers, and duties as are provided by law.

(b) Notwithstanding subparagraph (a) of this Paragraph, proceeds from general obligation debt issued for making loans to local government entities for water or sewerage facilities or systems or for regional or multijurisdictional solid waste recycling or solid waste facilities or systems as provided in Paragraph I(e) of this section shall be paid or transferred to and administered and invested by the unit of state government or state authority made responsible by law for such activities, and the proceeds and investment earnings thereof shall be applied and disbursed by such unit or authority.

Paragraph VIII. State aid forbidden.

Except as provided in this Constitution, the credit of the state shall not be pledged or loaned to any individual, company, corporation, or association. The state shall not become a joint owner or stockholder in or with any individual, company, association, or corporation.

Paragraph IX. Construction.

Paragraphs I through VIII of this section are for the purpose of providing an effective method of financing the state's needs and their provisions and any law now or hereafter enacted by the General Assembly in furtherance of their provisions shall be liberally construed to effect such purpose. Insofar as any such provisions or any such law may be inconsistent with any other provisions of this Constitution or of any other law, the provisions of such Paragraphs and laws
enacted in furtherance of such Paragraphs shall be controlling; provided,
however, the provisions of such Paragraphs shall not be so broadly construed as
to cause the same to be unconstitutional and in connection with any such
construction such Paragraphs shall be deemed to contain such implied
limitations as shall be required to accomplish the foregoing.

Paragraph X. Assumption of debts forbidden; exceptions.
The state shall not assume the debt, or any part thereof, of any county,
municipality, or other political subdivision of the state, unless such debt be
contracted to enable the state to repel invasion, suppress civil disorders or
insurrection, or defend itself in time of war.

Paragraph XI. Section not to unlawfully impair contracts or revive
obligations previously voided.
The provisions of this section shall not be construed so as to:
(a) Unlawfully impair the obligation of any contract in effect on June 30, 1983.
(b) Revive or permit the revival of the obligation of any bond or security declared
to be void by the Constitution of 1976 or any previous Constitution of this state.
O.C.G.A. §50-17-22 et seq.

(a) **Responsibilities.** Subject to the limitations contained in this article, the commission shall be responsible for the issuance of all public debt incurred hereunder, for the proper application of the proceeds of such debt to the purposes for which it is incurred, for the proper application of an appropriation to the commission for capital outlay to the purpose for which it is appropriated, and for the application and administration of this article; provided, however, that the proceeds of guaranteed revenue obligations shall be paid to the issuer thereof, and such proceeds and the application thereof shall be the responsibility of the issuer. The commission shall also be responsible for the proper disbursement of an appropriation to it for public school capital outlay, and the commission and the State Board of Education will be concurrently responsible for its proper application. The commission shall be responsible for the issuance of guaranteed revenue debt, except that bonds themselves evidencing such debt shall be in the name of the instrumentality of this state issuing the same and shall be issued and executed in accordance with the laws relative to such instrumentality and the applicable provisions of this article.

(b) **Organization.**

(1) The Governor shall serve as the chairman and chief executive officer; the presiding officer of the Senate shall serve as the vice-chairman of the commission; and the state auditor shall serve as secretary and treasurer. The chairman or vice-chairman or secretary and treasurer shall be the presiding officer at each meeting of the commission.

(2) There shall be a construction division of the commission administered by a director who shall not be a member of the commission and who shall also serve as the executive secretary for the commission. The director and the staff of the construction division shall be appointed by and serve at the pleasure of the commission, shall provide administrative support for all personnel of the commission, and shall account for and keep all records pertaining to the operation and administration of the commission and its staff. The director, as executive secretary, shall prepare agenda and keep minutes of all meetings of the commission. In construction and construction related matters, the construction division shall act in accordance with the policies, resolutions, and directives of the Georgia Education Authority (Schools) and the Georgia Education Authority (University) until such time as such policies, resolutions, or directives are changed or modified by the commission. In carrying out its responsibilities in connection with the application of any funds under its control, including the proceeds of any debt or any appropriation made directly to it for construction purposes, the commission is specifically authorized to acquire and construct projects for the benefit of any department or agency of the state or to contract with any such department or agency for the acquisition or construction of projects under policies, standards, and operating procedures to be established by the commission; provided, however, that the commission shall contract with the Department of Transportation or the Georgia Highway Authority or the State Road and Tollway Authority or any combination of the foregoing for the
supervision of and contracting for design, planning, building, rebuilding, constructing, reconstructing, surfacing, resurfacing, laying out, grading, repairing, improving, widening, straightening, operating, owning, maintaining, leasing, and managing any public roads and bridges for which general obligation debt has been authorized. The construction division also shall perform such construction related services and grant administration services for state agencies and instrumentalities and for local governments, instrumentalities of local governments, and other political subdivisions as may be assigned to the commission or to the construction division by executive order of the Governor.

(3) There shall also be a financing and investment division of the commission administered by a director who shall not be a member of the commission. The director shall be appointed by and serve at the pleasure of the commission. The financing and investment division shall perform all services relating to issuance of public debt, the investment and accounting of all proceeds derived from incurring general obligation debt or such other amounts as may be appropriated from time to time to the commission for capital outlay purposes, the guaranteed revenue debt and the proceeds thereof as may be directed by the commission and the issuer, the management of all other state debt, and such financial advisory matters and general accounting duties as are not specifically assigned to the executive secretary in paragraph (2) of this subsection and in subsection (g) of this Code section. The director of the financing and investment division shall report directly to the commission on all matters pertaining to the functions and duties assigned to the division.

(4) Members of the commission shall serve without compensation but shall receive actual expenses incurred by them in the performance of their duties. The expenses, including mileage, shall be paid on the same basis as for other state officials and employees.

(c) Meetings. The commission shall hold regular meetings as it deems necessary, but, in any event, not less than one meeting shall be held in each calendar quarter. The commission shall meet at the call of the chairman, vice-chairman, or secretary and treasurer or a majority of the members of the commission. Meetings of the commission shall be subject to Chapter 14 of this title, and its records shall be subject to Code Sections 50-18-70 and 50-18-71. The commission shall approve the issuance of public debt, as hereinafter provided, adopt and amend bylaws, and establish salaries and wages of employees of the commission only upon the affirmative vote of a majority of its members; all other actions of the commission may be taken upon the affirmative vote of a majority of a quorum present. A quorum shall consist of a majority of the members of the commission. If any vote is less than unanimous, the vote shall be recorded in the minutes of the commission.

(d) Powers. The commission shall have those powers set forth in the Constitution and the powers necessary and incidental thereto. In addition to such powers, the commission shall have power:

(1) To have a seal and alter the same at pleasure;

(2) To make contracts and to execute all instruments necessary or convenient, including contracts with any and all political subdivisions, institutions, or agencies
of the state and state authorities, upon such terms and for such purposes as it
deems advisable; and such political subdivisions, institutions, or agencies of the
state and state authorities are authorized and empowered to enter into and
perform such contracts;
(3) To employ such other experts, agents, and employees as may be in the
commission’s judgment necessary to carry on properly the business of the
commission; to fix the compensation for such officers, experts, agents, and
employees and to promote and discharge the same;
(4) To do and perform all things necessary or convenient to carry out the powers
conferred upon the commission by this article; and
(5) To make reasonable regulations or adopt the standard specifications or
regulations of the Department of Transportation or the state authorities, or parts
thereof, for the construction, reconstruction, building, rebuilding, renovating,
surfacing, resurfacing, acquiring, leasing, maintaining, repairing, removing,
installing, planning, or disposing of projects for which public debt has been
authorized, or for such other purposes as deemed necessary by the commission.
(e) Records. Except for those records specifically designated in this article to be
kept by the fiscal officer of the state, the commission shall be responsible for
keeping the records provided for in this article and such other records as it
deems necessary or convenient for the administration of this article.
(f) Advisory and service function.
(1) The commission is further vested with complete and exclusive authority and
jurisdiction in all financial advisory matters relating to the issuance or incurrence
of debt by state authorities as defined in paragraph (9) of Code Section 50-17-21;
and no such state authority shall be authorized, without the approval of the
commission, to employ other financial or investment advisory counsel in any
matter whatsoever or to incur debt without the specific approval of the
commission.
(2) When the commission performs financial advisory or construction related
services, the state authority or state agency requiring such services shall
reimburse the commission for such services.
(g) Budget unit; budget.
(1) The commission is designated a budget unit and shall be subject to Part 1 of
Article 4 of Chapter 12 of Title 45, the 'Budget Act.'
(2) The executive secretary shall prepare, under the direction and supervision of
the commission, any budgets, requests, estimates, records, or other documents
deemed necessary or efficient for compliance with Part 1 of Article 4 of Chapter
12 of Title 45, the 'Budget Act,' to provide for the payment of personnel services
and administration and otherwise carry out this article, provided that it is
expressly declared by the General Assembly that this subsection is only intended
to provide that the commission shall receive an appropriation for personnel and
administrative services. The commission need not receive an appropriation for
the costs of issuance, validation, and delivery of obligations to be incurred,
including, but not limited to, trustee’s fees, paying agent fees, printing fees, bond
counsel fees, district attorney fees, clerk of the superior court fees, architect fees,
and engineering fees, which costs and fees are dependent on the principal
amount of the obligations incurred and are determined to be appropriate costs of the project or projects for which such obligations are incurred and are authorized to be paid from bond proceeds. The commission need not receive an appropriation for expenditures made for fees and expenses incurred in safeguarding and protecting public health, life, and property in connection with projects for which general obligation debt has been incurred.

(h) **Retirement system.** All officers and employees of the commission shall be qualified to be and shall become members of the Employees’ Retirement System of Georgia; provided, however, that any such officer or employee who was on April 13, 1973, an officer or employee of any state agency, authority, department, or instrumentality and a member or participant in any annuity or retirement program other than the Employees’ Retirement System of Georgia, which person hereinafter is referred to as a ‘present employee,’ may elect to remain under such other annuity or retirement program or to transfer membership to the Employees’ Retirement System of Georgia. The commission is authorized to perform and shall perform all obligations of employer if such present employee shall elect to remain under such other annuity or retirement program. A present employee electing to transfer membership to the Employees’ Retirement System of Georgia under this article shall give notice of electing to transfer membership to the Board of Trustees of the Employees’ Retirement System of Georgia and simultaneously therewith shall give to the governing body of the other annuity or retirement program notice that it shall transfer to the Board of Trustees of the Employees’ Retirement System of Georgia the employer’s and employee’s contributions standing to his account. From and after the date of transfer of contributions, the present employee electing to transfer membership shall be a member of the Employees’ Retirement System of Georgia with membership service and prior service credits equivalent to those he would have accrued had he been a member of the Employees’ Retirement System of Georgia throughout the period of transferred creditable service. In lieu of the foregoing election, any present employee wishing to retain his rights under any private annuity or retirement program may assume responsibility for the payment of all costs of such program and may elect to become a member of the Employees’ Retirement System of Georgia effective the date upon which he becomes an officer or employee of the commission. Any present employee so electing to retain his rights may also receive membership service credit and prior service credit under the Employees’ Retirement System of Georgia for all or part of his service with any state agency, authority, department, or instrumentality, plus military service credit as otherwise provided by law, by paying to the Board of Trustees of the Employees’ Retirement System of Georgia, on terms acceptable to the Board of Trustees, all the employee’s contributions, plus regular interest thereon, which would have stood to his credit had he been a member of the Employees’ Retirement System of Georgia during the period of creditable service sought to be established. In the event of the latter election, the commission shall pay all employer’s contributions, plus regular interest thereon, attributable to the creditable service sought to be established. Any elections under this subsection shall be made in writing within six months from the date of appointment to office.
or employment by the commission.

(i) **Surety bonds.** All members and officers of the commission and such employees as the commission may designate shall be surety bonded in such amounts as determined by the commission.

(jj) **Exemptions from laws.** The commission shall not be subject to the following:

1. Articles 3 and 4 of Chapter 5 of this title;
2. Subpart 2 of Part 2 of Article 4 of Chapter 12 of Title 45, relating to approval of contracts;
3. Article 1 of Chapter 20 of Title 45; or
4. Code Sections 45-12-82, 45-12-83, 45-12-89, and 45-12-92.
Internal Revenue Code of 1986 as amended

The size of the Internal Revenue Code of 1986 makes it impossible to provide the document as an attachment. Therefore, you may utilize the online version of the Internal Revenue Code at the following web site:

http://www.fourmilab.ch/ustax/ustax.html
Internal Revenue Code Summary Dated June 16, 2004 Authored by King and Splading
EXHIBIT "A"

to

GEORGIA STATE FINANCING AND INVESTMENT COMMISSION
POLICY AND PROCEDURE DIRECTIVE REGARDING
STATE OF GEORGIA GENERAL OBLIGATION BONDS
AND PUBLIC/PRIVATE PARTNERSHIPS

Tax-exempt general obligation bonds may be issued by the State of Georgia (the "State") to finance governmental\(^1\) facilities under the Internal Revenue Code of 1986, as amended (Code).\(^2\) The Code imposes numerous restrictions and limitations on the issuance of tax-exempt bonds by the State. In order to be issued on a tax-exempt basis at lower interest rates, State general obligation bonds for financing governmental facilities must be classified as governmental bonds under the Code. The purpose of this Exhibit is twofold: to provide a basic understanding of governmental bonds and what could cause them to be treated as private activity bonds (PABs) under the Code, and to review the opportunities provided to the State to work with the private sector, sometimes termed public/private partnerships.

Governmental bonds may be used for almost any purpose except that private entities may not significantly use, manage, or own the facilities financed.\(^3\) Nevertheless, Treasury Regulations (the “PAB Regulations”), together with Revenue Procedures 97-13, 97-14, and 97-15 ("Revenue Procedures" or "Rev. Proc." ) broaden the opportunities for public/private partnerships.

The next section of this Exhibit addresses the factors to be considered in determining whether State general obligation bonds financing governmental projects may be classified as governmental bonds under the Code as of the date of this Exhibit. A discussion of how facilities financed with governmental bonds can be used in public/private partnerships or "privatized" under the PAB Regulations and the Revenue Procedures follows.

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1 The term governmental is used to refer to a state or local government unit as defined under § 103 of the Code and the regulations promulgated thereunder.

2 The discussion throughout this Exhibit assumes that tax-exempt financing rather than taxable financing of a facility is the most desirable financing alternative. This is undoubtedly true when interest rate is the sole consideration. In limited cases, the use of taxable bonds may be a financing alternative—where, for example, the State desires to use the facility free of Code restrictions. However, the State has never issued taxable general obligation bonds. Each State department or agency, therefore, should be aware that there are many factors to consider in determining whether to use tax-exempt governmental bonds to finance a facility. Due to elaborate and sometimes stringent Code restrictions on the use of proceeds, any facility financed in whole or part with tax-exempt State general obligation bond proceeds should be undertaken only with the advice of the Construction Division of GSPIC.

3 Section 141(d) of the Code contains the primary federal tax limitation on the type of project that can be financed with governmental bonds. Of course, there are federal and state constitutional barriers to the financing of a facility (e.g., anti-establishment clause would prevent financing of a facility for religious worship). In addition, any financing must be permitted by State law.
CLASSIFICATION AS GOVERNMENTAL BONDS

General Discussion

State general obligation bonds are classified as governmental bonds under the Code. Governmental bonds are tax-exempt. Whether bonds are governmental bonds or private activity bonds ("PABs") turns on whether there is an arrangement, other than a grant, that will actually or potentially transfer the benefits of tax-exempt financing to nongovernmental persons. This section focuses on the rules developed by the PAB Regulations to make this determination.

Definition of a Governmental Bond

A governmental bond is a State general obligation bond that does not meet the definition of a PAB. A bond is a PAB if the State reasonably expects, as of the issue date, that the issue will meet either the private business tests or the private loan financing test under the Code. An issue is also a PAB if the State takes a deliberate action subsequent to the issue date that causes the private business tests or private loan financing test to be met. The private business tests consist of the private business use test and the private security or payment test. The private business tests and the private loan financing test are each discussed below.

The State's reasonable expectations must take into account reasonable expectations about events and actions over the entire term of the issue. A reasonably expected subsequent deliberate action may be disregarded under certain circumstances if the bonds are subject to mandatory redemption on the occurrence of such action or as a consequence thereof. Two other special rules with elaborate conditions permit disposition of personal property in the ordinary course of an established governmental program and the unexpected disposition of any kind of property in the context of a general obligation bond program that finances a large number of separate purposes. Further, certain remedial actions, which are discussed in the "Privatization" section, can be taken by the State to prevent a deliberate action taken with respect to bond financed property from causing the issue to be treated as PABs and thus taxable.

Private Business Use Test. In general, the private business use test is met if private business use exceeds 10 percent of the proceeds of the issue over the measurement period (defined below). Use of facilities by natural persons (humans) (not using the facilities in a trade or business) and use by state or local governments is not treated as private business use. Likewise, use by private business persons of the financed property on the same basis as the general public is not treated as meeting the private business use test.4 However, use pursuant to special legal entitlements is treated as private business use unless the exceptions discussed below apply. In addition, use by private business users receiving "a special economic benefit" is also treated as private business use if the financed facility is not available for general public use. Under the PAB Regulations, special legal entitlements to use property can result from ownership, a lease, a management or incentive contract, a take-or-pay contract, an output

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4 Property is treated as available for use by the general public if it is intended to be available, and is in fact reasonably available, for use on the same basis by private business persons in their trades or businesses and by natural persons not in their trades or businesses ("general public use"). However, arrangements with nongovernmental persons exceeding 180 days will not generally be treated as general public use.

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contract, a research agreement, or any other arrangement that conveys special legal entitlements comparable to the foregoing, such as arrangements conveying priority rights to the use or capacity of a facility.

- **Special Economic Benefit.** If the financed property is not available to the general public, then any "special economic benefit" should be counted as private business use. The PAB Regulations provide that *special economic benefit* is to be determined based on all the facts and circumstances including one or more of the following factors: (1) the functional relationship and physical proximity of the property financed to other property used by a nongovernmental person; (2) a small number of nongovernmental persons receive the special economic benefit; and (3) a nongovernmental person depreciates the financed property.

- **Measurement of Private Business Use.** As a general rule the amount of private business use of property is determined according to the average percentage of private business use of the property during the measurement period. The *measurement period* is the period beginning on the later of the issue date of the issue or the date the property is placed in service; it ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity of any bond of the issue financing the property. The average percentage of private business use is the average of the percentages of private business use during the one-year periods within the measurement period. The percentage of private business use for any one-year period is the average private business use during that year calculated and expressed as the ratio of private business use during the year to the total private business use and nonprivate business use ("governmental use") during that year. An anti-abuse rule prevents the establishment of an unreasonably long term of an issue for a principal purpose of increasing the permitted amount of private business use.

The amount of private business use resulting from private ownership is calculated differently. In cases of private business ownership a special rule provides that the amount of private business use is determined according to the *greatest* percentage of private business use in any one-year period. Other significant special measurement rules eliminate the consideration of facility downtime in calculating the average percentage of private business use, but permit, under certain circumstances, a discrete portion of a facility to be treated as a separate facility. In addition, if private business use as of the issue date is reasonably expected to have a significantly greater fair market value than governmental use would have, the average amount of private business use must be determined according to relative reasonably expected fair market values of use rather than by another measure, such as average time of use. Further, if private business use and actual governmental use of a facility is on the same basis and occurs simultaneously, the average amount of private business use may be determined on a reasonable basis that reflects the proportionate benefits to each user.

- **Exceptions.** There are a number of exceptions for certain types of private business use that may have otherwise been counted toward satisfaction of the private business use test. These exceptions include private business use resulting from:
• certain management or service contracts involving expense reimbursement, incidental services or de minimis services (for example, contracts providing for services on an actual and direct reimbursement basis, contracts for janitorial services, or arrangements granting admitting privileges to doctors in return for being on call for the hospital’s patients on an occasional basis);

• use of facilities by nongovernmental persons solely in their capacity as agents of a governmental person;

• certain incidental private business uses, including use in the capacity as a bond trustee, servicer, or guarantor of the bonds;

• contracts not reasonably available to natural persons with rates set by general tariffs and a term not longer than 90 days;

• negotiated arm’s-length contracts with terms not longer than 30 days;

• use under arrangements on the same basis as natural persons not engaged in a trade or business (previously referred to as “general public use”); and

• use by a developer during the development period under certain conditions.

Rev. Proc. 97-13 and 97-14 provide exceptions for management agreements, service agreements, and research agreements meeting certain safe harbor guidelines (see “Privatization” below).

• Project Tracking. Under the PAB Regulations, reasonable and consistently applied accounting methods must be used to allocate proceeds to expenditures. Allocations of bond proceeds to expenditures are also required to be consistent with the arbitrage rules under Treasury Regulation § 1.148-6(d). If the State fails to maintain sufficient records it is deemed to use a specific tracing method. The State is required to account for expenditures not later than 18 months after the later of the date of expenditure or the date the financed property is placed in service but, in no event can this be later than 60 days after the fifth anniversary of the issue date or the date of retirement of the bonds.

Private Security or Payment Test. In general, the private security or payment test is satisfied if the present value of the payments to be taken into account exceeds 10 percent of the present value of the debt service to be paid over the term of the issue. The private payment portion of the test generally takes into account payment of debt service derived from payments (whether or not to the State or a related party) in respect of property or borrowed money used or to be used for a private business use. The private security portion of the test generally takes into account payment of debt service directly or indirectly secured by an interest in property used or to be used for a private business use, or payments in respect of such property.5 Applying this test

5 There is a special rule that prevents the same payment from being taken into account as both private security and private payments.
is the second step in determining whether an issue is a PAB. For an issue to be a PAB it must meet the private business use test and the private security or payment test.\(^6\)

The security for an issue and the payment of debt service on the issue are determined on the basis of both the bond documents and any underlying arrangement between the parties. An underlying arrangement can result from separate agreements between the parties or may be inferred from all the facts and circumstances in connection with the issuance of the bonds.

- **Measurement Rules.** Special measurement rules that facilitate the calculations required by the private security or payment test are beyond the scope of this Exhibit, although a few key rules are discussed here. Present values are determined by using the yield on the issue as the discount rate for a fixed-yield issue. Variable-yield issues may assume that the then-current interest rate is the discount rate over the term of the issue. A subsequent deliberate action will cause a recalculation of the variable yield. Adjustments to debt service may be made to take into account qualified guarantees.

- **Payments Taken into Account.** Generally, payments made by any private business user, as determined by the private business use test, are taken into account. Payments are taken into account only for the period of time that the property is being used for the private business use. Payments for use of the financed property include payments in respect of such property even if not made by a private business user (but only to the extent that they are available to be used directly or indirectly for debt service).

Payments from a private business user are not counted to the extent that such payments exceed the present value of debt service allocable to the proceeds used by such private business user. Payments for use of proceeds do not include the portion of any payment properly allocable to the payment of direct operating expenses of the financed property used by the private business user. A special rule in the PAB Regulations generally characterizes payments of debt service on a refinanced issue as private payments in the same proportion as private payments bear to total payments on the refunding issue [Reg. § 1.141-4(c)(2)].

There are special rules for allocating private payments when property is financed from multiple funding sources (for example, taxable, tax-exempt, or equity funding). As a general rule, payments for the use of property are allocated, based on all of the facts and circumstances, to the source or different sources of funding of property. In general, a private payment for the use of property is allocated to a source of funding based on the nexus between the payment and both the financed property and the source of funding. Payments for the use of a discrete facility (or discrete portion of a facility) are allocated to the source or sources of funding of that discrete property. Payments made for the use of property financed with two or more sources of funding, where no clear nexus to a source of funding can be established, are required to be allocated to those sources of funding in a manner that reasonably corresponds to the relative amounts expended on the property by each source. Allocations may be made according to relative

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\(^6\) The private security or payment test, among other things, allows the State to make grants from the proceeds of governmental bonds to private persons.
amounts of debt service if such allocation method reasonably reflects the economic substance of the arrangement [Reg. § 1.141-4(c)(3)].

Two other special allocation rules, found in Treasury Regulation § 1.141-4(c)(3), are in the nature exceptions to the general rules. Under one rule, private payments under an arrangement entered into in connection with the issuance of the bonds are generally allocated to that issue. Under the other rule, the State may not allocate a private payment to reimburse itself for equity contributions unless, not later than 60 days after the date of expenditure of those amounts, the State adopts an official intent resolution comparable to that required by Treasury Regulation § 1.150-2(e) and reimburses itself reasonably promptly.

- **Security Taken into Account.** As a general rule, private security consists of financed property used by a private business user as well as payments in respect of that property if any interest in that property or payments secures the payment of debt service on the bonds. Under this rule the payments in respect of privately used property can be counted even if they are from the general public (but only to the extent that they are available to be used directly or indirectly for debt service).

A special rule provides that private security that is not bond financed is taken into account only to the extent that it is provided by a user of the proceeds of the issue. Generally, proceeds of a bond issue are not taken into account prior to expenditure or loan to the private user.

Consistent with the rules concerning payments, private security is not taken into account (1) for the period of time the property is not being used for private business use or is not serving as security, and (2) to the extent that it exceeds the amount of allocable private business use. Private security is generally taken into account with respect to refunded issues in the same proportion as private security bears to total payments on the refunding issue.

Finally, a special rule provides for the allocation of private security or payments (from the disposition of such property securing the issue) among multiple issues secured by such property or payments. The rule provides that such security or payments are allocated on a reasonable basis that takes into account bondholders’ rights to the payments or property on default.

- **Generally Applicable Taxes.** For purposes of the private security or payment test, taxes of general application are not taken into account. The PAB Regulations say that a “generally applicable tax is an enforced contribution exacted pursuant to legislative authority in the exercise of the taxing power . . . “to raise revenue for governmental purposes. The tax must have uniform rate applicable to all persons of the same class in the jurisdiction and a generally applicable manner of determination and collection. A special rule permits payments in lieu of taxes to constitute generally applicable taxes under certain circumstances. Other special rules list the types of agreements relating to the payment of taxes that will be permissible.

**Output Facilities.** Governmental bonds more than 5 percent of the proceeds of which are used to finance output facilities (other than facilities for the furnishing of water) are subject to
more restrictive private business tests. There are also a number of special rules that apply to output facilities in general, including facilities for the furnishing of water. Those rules are contained in Treasury Regulation § 1.103-7(b)(5), “Output Regulations.” Output facilities include electric and gas generation and transmission or related facilities. Under the Code, if the nonqualified amount exceeds $15 million, such issue is treated as a PAB. The nonqualified amount is defined as the lesser of (1) the proceeds of the issue that are subject to private business use, or (2) the proceeds of the issue with respect to which the private security or payments test has been met. The aggregate nonqualified amount of all prior outstanding issues with respect to the same project are counted against this $15 million limitation.

The Private Loan Financing Test. Bonds are PABs if more than the lesser of 5 percent or $5 million of the proceeds of the issue is to be used (directly or indirectly) to make or finance loans to persons other than governmental persons. The State’s reasonable expectations and subsequent deliberate actions, as discussed in “Definition of a Governmental Bond” above, are taken into account. The amount actually loaned to a nongovernmental person is not discounted to reflect the present value of loan payments.

For purposes of this test, a private loan is any transaction characterized as a loan for federal tax purposes. In addition, a loan can arise from the direct lending of bond proceeds or from transactions that convey indirect benefits that are the economic equivalent of a loan. Loans that are nonpurpose investments do not cause the private loan financing test to be met.

Certain prepayments for property or services are also treated as loans for the purpose of the private loan financing test if the principal purpose of such prepayments is to provide tax-exempt financing to the seller. A prepayment is not treated as a loan for purposes of this test if either (1) the prepayment is made for a substantial business purpose other than providing tax benefits to the seller and the State has no commercially reasonable alternative to the prepayment, or (2) substantially similar prepayments are made by a substantial percentage of persons similarly situated to the State who do not use tax-exempt financing.

A special rule affirms that a grant is not a loan. The determination of whether a transaction is characterized as a grant or a loan is based on all the facts and circumstances. Generally, a grant made from proceeds of an issue secured by generally applicable taxes attributable to improvements made with the grant is not treated as a loan. Certain impermissible agreements entered into with the grantee, however, could cause a grant to be treated as a loan. An example is an agreement to be personally liable on a tax that does not generally impose personal liability.

Unrelated or Disproportionate Use Test. Under this test, an issue meets the private business tests if the amount of private business use and private security or payments attributable to unrelated or disproportionate private business use exceeds 5 percent of the proceeds of the issue. Application of the test requires a three-step analysis. The first step is to determine whether the private business use or uses are related to a governmental use. The second step is to examine the private business use to determine whether it is disproportionate to its related governmental use. In the third step, all unrelated private business uses and disproportionate related uses are aggregated to determine whether the 5 percent threshold has been exceeded.
Unrelated use is determined on a case-by-case basis that emphasizes the operational relationship between the governmental use and the private business use. In general, a related privately used facility is required to be located within or adjacent to the governmentally used facility. Two other special rules provide some additional guidance. The first rule provides that a private business use is related to a governmental use if the uses of the facility are for the same purpose and the governmental use is not insignificant. The second rule provides that use of a facility in the same manner for both related and unrelated private business uses will not result in unrelated private business use if the related use is not insignificant. For example, a private pharmacy in a governmentally owned hospital will not ordinarily result in unrelated use solely because the pharmacy serves individuals who are not patients of the hospital.

A private business use is disproportionate to a related governmental use to the extent that the amount of bond proceeds used for that private business use exceeds the amount of bond proceeds used for governmental use. For example, a private business use of $100 in proceeds and a related governmental use of $70 in proceeds results in $30 of disproportionate use. There are special rules that aggregate related uses and allocate private business use among governmental uses, and that require the amount of unrelated use or disproportionate use of a facility to be based on the maximum amount of reasonably expected governmental use of a facility during the measurement period. Thus, the State is not penalized for having initial excess capacity in a facility that is to be used by nongovernmental persons prior to its complete use by the State.

PUBLIC/PRIVATE PARTNERSHIPS; PRIVATIZATION

This section discusses the major public/private partnership or privatization options available to the State, beginning with a consideration of the terms that must be included in management and service agreements in order to avoid any resulting private business use, and then the terms that must be in research agreements, also to avoid any resulting private business use. It next considers the remedial actions the State can take if it wishes to sell or lease facilities financed by governmental bonds without causing outstanding bonds to become taxable on a retroactive basis.\(^7\)

Management, service, and research agreements are commonly used by departments and agencies of the State who wish to retain ownership of facilities but involve private businesses in the operations and/or maintenance of a facility financed with governmental bonds. Sale options are typically used by the State if a facility is no longer needed or is obsolete. Lease options are generally used when a facility has excess space.

Management and Service Agreements

\(^7\) As a general rule, privatization actions that involve asset dispositions or facility leases (or other arrangements involving priority rights) to private business users resulting in private business use will cause outstanding tax-exempt bonds to become taxable on a retroactive basis unless the State takes the remedial actions specified in the PAB Regulations. The permissible types of remedial actions include redemption, defeasance, alternative qualified use of facilities, and qualified use of disposition proceeds. The PAB Regulations have a special rule that does not require any further remedial actions with respect to certain issues with mandatory redemption provisions that require the State to redeem bonds within six months of the privatization action. See Treas. Reg. § 1.141-2(d)(ii).
As discussed in the section “Private Business Use Test,” special legal entitlements arising from management and service agreements (management contracts) can result in private business use and satisfaction of the private business use test. However, the IRS and Treasury have appropriately recognized that there are circumstances where these types of arrangements are not likely to transfer the benefits of tax-exempt financing to nongovernmental persons.

The PAB Regulations outline the general rules that the State in financing facilities with governmental bonds is required to follow when it negotiates a management contract with a nongovernmental person to avoid any private business use. Rev. Proc. 97-13 sets forth five types of compensation arrangements that the IRS believes do not create any private business use. Because the State, its departments and agencies engage in commerce with the private sector, it will be necessary for any management contract negotiation to take into account the provisions of the PAB Regulations concerning management contracts and the guidelines established by Rev. Proc. 97-13.

The PAB Regulations. The PAB Regulations provide both a definition of the term management contract and a general framework for structuring a management contract that will not result in any private business use. A management contract is defined as a management, service, or incentive payment contract between a governmental person and a nongovernmental service provider (“service provider”) under which the service provider performs services involving all, a portion of, or any function of a facility. This definition is so broad that there are specific exceptions for service contracts incidental to the facility’s primary function, for certain reimbursement contracts, and for certain arrangements with physicians. However, a contract in the form of a management contract may nevertheless result in private business use if it can be recharacterized as a lease or sale under general federal income tax principles.

The PAB Regulations provide the general rule that whether a contract is a management contract resulting in private business use is determined based on all the facts and circumstances. Rev. Proc. 97-13 provides further guidance with respect to this general standard. However, as a general rule, a management contract results in private business use if the contract provides for compensation for services rendered based, in whole or in part, on a share of net profits from the operation of the facility.

Revenue Procedures 97-13

Rev. Proc. 97-13 establishes the parameters for five general types of compensation arrangements. These are 95 percent periodic fixed-fee arrangements, 80 percent periodic fixed-fee arrangements, 50 percent periodic fixed-fee arrangements, per-unit fee arrangements, and percentage of revenue or expense fee arrangements. Each type of arrangement has specific limitations concerning compensation methods, length of contract, and cancellation provisions, if applicable. Rev. Proc. 97-13 is effective for any management contract entered into, materially modified, or extended (other than pursuant to a renewal option). What follows is a discussion of the key requirements of each of the five paradigm compensation arrangements. It should be noted that the standards of Rev. Proc. 97-13 cannot be utilized as a safe harbor if the service provider has any role or relationship with the State, its departments or agencies that would
substantially limit such user's rights, including cancellation rights, if any, under the contract, based on all the facts and circumstances.  

- **Ninety-Five Percent Periodic Fixed-Fee Arrangements.** Under this arrangement, at least 95 percent of the annual compensation during the term of the contract must be based on a periodic fixed fee and the contract term (including renewal options) may be fifteen years provided it doesn't exceed 80 percent of the reasonably expected useful life of the financed property (the "80 Percent Useful Life Rule"). In addition, a one-time incentive award based on the reaching of a gross revenue or expense target during the term of the contract will not disqualify the contract.

- **Eighty Percent Periodic Fixed-Fee Arrangements.** Under this second type of arrangement, at least 80 percent of the annual compensation during the term of the contract must be based on a periodic fixed fee. The contract term (including renewal options), however, may be as long as ten years subject to the limit of the 80 Percent Useful Life Rule. In addition, a one-time incentive award is permitted and the contract term can be as long as twenty years for public utility property.

- **Fifty Percent Periodic Fixed-Fee Arrangements.** Under this third type of arrangement, which has greater flexibility, at least 50 percent of the annual compensation during the term of the contract must be based on a periodic fixed fee or all of the compensation for services is based on a capitation fee. These rules also apply to the arrangements discussed in "Per-Unit Fee Arrangements" and Percentage of Revenue or Expense Fee Arrangements below, or a combination of a capitation fee and a periodic fixed fee. The maximum term of the contract (including renewal options) is five years. This stricter term limitation appears to be imposed because of the greater potential of this type of arrangement for transferring the benefits of tax-exempt financing to a private business user. A further limitation requires that the contract be terminable by the State on reasonable notice, without penalty or cause, at the end of the third year of the contract term. Special rules define what contract

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8 Rev. Proc. 97-13 treats this requirement as met if (1) not more than 20 percent of the voting power of the State is vested in the service provider and its directors, officers, shareholders, and employees; (2) overlapping board members do not include the chief executive officers of the service provider or its governing body or the State or its governing body; and (3) the State is not related to the service provider.

9 The term *periodic fixed fee* means a stated dollar amount for services rendered for a specified period of time. The stated dollar amount may automatically increase according to a specified, objective, external standard that is not linked to output or efficiency of a facility.

10 Rev. Proc. 97-13 generally permits annual productivity rewards based on increases or decreases in gross revenues (or adjusted gross revenues), or reduction in total expenses. Such rewards, however, are usually treated as variable fees and not periodic fixed fees (unless the reward occurs only once over the term of the management contract and is based on gross revenues or expenses). However, in the case of the 50 percent periodic fixed-fee arrangements discussed under the "Revenue Procedures 97-13" section, such annual productivity rewards usually constitute variable fees in any event.

11 A *capitation fee* is defined as a fixed periodic amount for each person for whom the service provider or user assumes the responsibility to provide all needed services for a specified period so long as the quantity and type of services actually provided to each person varies substantially.
provisions constitute penalties. Loans or other guarantees may create termination penalties in certain circumstances.

- **Per-Unit Fee Arrangements.** Under this fourth type of arrangement, all compensation for service is based on a per-unit fee or a combination of a per-unit fee and a periodic fixed fee. The term of the contract (including renewal options) cannot exceed three years. It is required that the contract be terminable by the State on reasonable notice, without penalty or cause, at the end of the second year of the contract term.

- **Percentage of Revenue or Expense Fee Arrangements.** This fifth and last type of arrangement described in Rev. Proc. 97-13 has the most limited applicability because of its inherent greater potential to transfer the benefits of tax-exempt financing to a private business user. Under this arrangement, all of the compensation for services is based on a percentage of fees or a combination of per-unit fee and a percentage of revenue or expense fee. However, during the start-up period, compensation may be based on a percentage of either gross revenues, adjusted gross revenues, or expenses of a facility. The contract term (including renewal options) may not exceed two years. In addition, the contract must be terminable by the State on reasonable notice, without penalty or cause, at the end of the first year of the contract. This arrangement is limited to start-up situations and contracts where the service provider provides services to third parties.14

**Research Agreements**

The PAB Regulations provide, subject to the exceptions noted under “Private Business Use Test,” that an agreement by a nongovernmental person to sponsor research performed by the State may result in private business use of the property used for the research based on all the facts and circumstances. Rev. Proc. 97-14 sets forth two basic types of arrangements that the IRS believes do not create private business use. An agreement in the form of a research agreement may result in private business use if the sponsor is treated as the lessee or owner of the financed property for federal income tax purposes.

Under the first type of arrangement described in Rev. Proc. 97-14, a research agreement relating to property used for basic research supported by a nongovernmental sponsor will not result in any private business use, provided that any type of license (including exclusive licenses) or other use of resulting technology by such sponsor is obtained based on competitive terms including price (determined at the time the technology is available for use). Basic research for

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12 These rules also apply to the arrangements discussed in “Per-Unit Fee Arrangements” and Percentage of Revenue or Expense Fee Arrangements below.

13 Per-unit fee is defined to mean a fee based on a unit of service specified in the contract or otherwise specifically determined by an independent third party or the State. Separate billing arrangements between physicians and hospitals are treated as per-unit fee arrangements.

14 For example, a qualifying contract between a governmental hospital and a physician or physician’s group may provide that a physician or physicians’ group will receive a certain percentage of the fees charged by the physician or physicians’ group for services rendered at the hospital.
purposes of § 141 of the Code is broadly defined to mean any original investigation for the advancement of scientific knowledge not having a specific commercial objective.

Under the second type of arrangement described in Rev. Proc. 97-14, a research agreement relating to property used pursuant to a joint industry-government cooperative research arrangement will not result in private business use so long as the following four conditions are met:

1. Multiple unrelated nongovernmental sponsors agree to fund governmentally performed basic research.

2. The State determines the research to be performed and the manner of performance.

3. The State takes exclusive title to any patent or other product incidentally resulting from the basic research.

4. Sponsors can obtain no more than nonexclusive, royalty-free licenses to use any resulting products.

Remedial Actions

The PAB Regulations prescribe three types of remedial actions that the State can take with respect to nonqualified bonds (defined below in “Redemption or Defeasance of Nonqualified Bonds”). If the State, its departments and agencies act in accordance with the requirements of any remedial action provision can disregard any subsequent deliberate action that would cause the private business tests or the private loan test to be met. The three remedial actions are (1) redemption or defeasance of nonqualified bonds, (2) alternative use of disposition proceeds, and (3) alternative use of facility. Rev. Proc. 97-15, which is also discussed below, offers the State a remediation “payment” option under certain circumstances. This option is likely to be utilized only when bonds are close to their call date, or when the State has no other reasonable alternative available to maintain the tax-exempt status on outstanding bonds.

Conditions to Taking Remedial Action. Under the PAB Regulations there are five conditions that must be met in order to take remedial actions: (1) the reasonable expectations test is satisfied, (2) the bond issue is without an excessive term, (3) fair market value consideration is paid, (4) disposition proceeds are treated as gross proceeds for purposes of § 148 of the Code, and (5) the proceeds of the issue are expended on a governmental purpose (except for redemption/defeasance remediation alternative). Failure to meet any one of the applicable criteria eliminates the ability of the State to take remedial action under the PAB Regulations.

To meet the first condition, the State must have “reasonably expected” on the issue date that the issue would neither meet the private business tests nor the private loan test for the entire term of the bond. 15 To meet the second condition, the term of the issue being remediated must

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15 The phrasing of the reasonable expectations test in the past tense requires a reexamination of the reasonable expectations test set forth in § 1.141-2(d) of the PAB Regulations. If the reasonable expectations test was met on
not be longer than reasonably necessary for the governmental purposes of the issue. This requirement is met if the average maturity of the bonds of the issue is not greater than 120 percent of the average reasonably expected economic life of the property financed with proceeds of the issue as of the issue date.\textsuperscript{16}

Satisfaction of the third condition requires any arrangement entered into by the State, which would otherwise result in satisfaction of the private business tests or the private loan test, to be bona fide and arm’s length. In addition, any new user is required to pay fair market value for the use of the financed property. Fair market value may take into account use restrictions imposed to serve a bona fide governmental purpose. Satisfaction of the fourth condition requires the State to treat any disposition proceeds as gross proceeds for purposes of the arbitrage rules. The fifth and last condition appears to limit the State to the redemption or defeasance of the outstanding nonqualified bonds if there are any unexpended proceeds of the issue that are affected by the deliberate action.

\textit{Redemption or Defeasance of Nonqualified Bonds.} This remedial action alternative requires redemption of all nonqualified bonds. The PAB Regulations define, for purposes of the remedial action provisions, the \textit{amount of non qualified bonds} to be the amount determined by multiplying the highest percentage of private business use in any one-year period (commencing with the date of deliberate action) by the amount of outstanding bonds.\textsuperscript{17} If the nonqualified bonds are not redeemed within 90 days of the date of deliberate action, a defeasance escrow (with the yield on investments restricted to bond yield) must be established for those bonds within 90 days of the deliberate action, and the Commissioner of the Internal Revenue Service must be notified of the escrow within the same period. Proceeds of tax-exempt bonds are not permitted to be used for redemption or defeasance unless the tax-exempt bonds are qualified bonds, taking into account the purchaser’s use of the facility. In addition, in order to use the defeasance remedial action, the period between the issue date and the first call date of the nonqualified bonds is required to be no more than ten and a half years.

A special rule for cash sales permits disposition proceeds to be used to redeem a pro rata portion of nonqualified bonds at the earliest call date after the date of deliberate action if there is a cash shortfall and there are insufficient funds to redeem all nonqualified bonds. If the bonds are not redeemed within 90 days of the deliberate action, the disposition proceeds must be used to establish a defeasance escrow within such 90-day period.

\textit{Alternative Use of Disposition Proceeds.} The requirements for this type of remedial action are met if the following four conditions are satisfied: (1) the facility is disposed of

\textsuperscript{16} The requirement that the maturity of the issue not be unreasonably long may prevent the State from using the remedial action provisions retroactively if it has not kept adequate records of the property financed with the proceeds of the issue as of the issue date.

\textsuperscript{17} The PAB Regulations provide that allocations to nonqualified bonds are required to be made on a pro rata basis except that, for purposes of redemption or defeasance, the State may treat bonds with longer maturities as nonqualified bonds.
exclusively for cash; (2) the disposition proceeds\textsuperscript{18} are reasonably expected to be spent within two years of the date of deliberate action; (3) the disposition proceeds are used in a manner that does not satisfy the private business tests or the private loan financing test (and there are no further deliberate actions that would cause these tests to be met); and (4) any remaining unspent disposition proceeds are used in a manner that satisfies the requirements for the redemption/defeasance remedial action discussed above in the section on “Redemption or Defeasance on Nonqualified Bonds.”

\textit{Alternative Use of Facility.} The requirements for this type of remedial action are met if the following four conditions are satisfied: (1) the facility is used in an alternative manner;\textsuperscript{19} (2) the nonqualified bonds are treated as reissued, as of the date of the deliberate action for purposes of Code §§ 59, 141, 142, 144, 145, 146, 147, 149, and 150, and satisfy all the applicable requirements for qualified bonds throughout their remaining term;\textsuperscript{20} (3) the deliberate action does not involve the purchase of the facility with proceeds of another issue of tax-exempt bonds; and (4) any disposition proceeds resulting from the deliberate action (other than in-kind), including proceeds from an installment sale, are either used to pay debt service on the bonds on the next available payment date, or, within 90 days of receipt, are deposited in an escrow restricted to the yield on the bonds pending expenditure for debt service on the next available payment date.

\textit{Revenue Procedures 97-15.} Rev. Proc. 97-15 was issued by the IRS pursuant to § 1.141-12(h) of the PAB Regulations, which gives the Commissioner the authority to provide for additional remedial actions including making a remedial payment to the United States. In order to use this Rev. Proc. 97-15, the State is required to meet the conditions to take remedial actions set forth in “Conditions to Taking Remedial Action” above.

Under the program established by Rev. Proc. 97-15, the IRS will enter into a closing agreement with the State that will provide that interest on the bonds will not be includable in the gross income of bondholders and/or interest on bonds will not be treated as an item of tax preference for purposes of the AMT solely as a result of the subsequent deliberate action.

To qualify for this closing agreement program, the State has to satisfy a number of technical requirements and to pay an estimate of the federal income tax liability that is not required to be paid from the date of the deliberate action as a result of the closing agreement. To maintain the tax exemption on the nonqualified bonds, the amount that must be paid is the present value of the amounts determined by multiplying interest accruing each year to the next redemption date on the nonqualified bonds by 29 percent. To maintain the status of the bonds as non-AMT bonds, a similar procedure is followed for the period of time set forth in the closing

\textsuperscript{18} The PAB Regulations define \textit{disposition proceeds} as any amounts (including property, such as an agreement to provide services) derived from the sale, exchange, or other disposition of property (other than investments) financed with proceeds of the issue. There are special allocation rules applicable to disposition proceeds where property has been financed from different funding sources.

\textsuperscript{19} For example, any use for which a qualified bond could be issued (except for qualified bonds involving loans to natural persons) would meet this condition.

\textsuperscript{20} Under these rules, if the State wishes to have a reissued bond treated as a qualified bond under current law, certain actions—including elected-official approval and volume cap allocation, if applicable (but not § 147(d) of the Code) must occur prior to the deliberate action.
agreement except the multiplier is 0.14 percent. Present value is determined on the basis of a discount rate equal to the taxable applicable federal rate, with semi-annual compounding determined as of the date of the deliberate action.

It would be excessively costly for the State to utilize Rev. Proc. 97-15 to maintain an issue’s tax exemption unless the bonds are close to their call date or unless there is no other reasonable alternative. Nevertheless, it still make sense for the State to utilize Rev. Proc. 97-15 for relief from the AMT, since the remedial payment option is a reasonably inexpensive option compared to other alternatives.

**SUMMARY**

The goal of the State is to raise capital in the financial marketplace at the lowest possible cost. Tax-exempt governmental bonds make them the lowest-cost alternative. However, the private business tests, the private security or payment test, and the private loan financing test all serve to limit the degree of private-sector involvement with facilities that are financed with State general obligation bonds which are governmental bonds under the Code. These tests were discussed in detail in the section “Classification of Governmental Bonds.”

The PAB Regulations and the Revenue Procedures have expanded the opportunities for the State to work with the private sector. Every State department or agency that engages in commerce with the private sector will need to take into account the guidelines of Rev. Proc. 97-13 (management and service agreements) and the guidelines of Rev. Proc. 97-14 (research agreements). These revenue procedures are discussed in the “Privatization” section under “Management and Service Agreements” and “Research Agreements” above.

State departments or agencies wishing to sell or lease facilities financed by governmental bonds to the private sector without causing such bonds to be retroactively taxable may need to take a remedial action provided by the PAB Regulations. To the extent that the State fails to meet all the requirements necessary to remEDIATE under the PAB Regulations, Rev. Proc. 97-15 offers issuers the opportunity to make cash remediation payments to the United States based on the estimate of the IRS of lost tax revenues. It is unlikely that the State will utilize Rev. Proc. 97-15 because it will be costly. The types of remedial action alternatives permitted by the PAB Regulations and Rev. Proc. 97-15 including redemption or defeasance, alternative use of disposition proceeds, alternative use of facility and remediation payment to the United States are discussed in detail in the “Privatization” section under “Remedial Actions.”
MEMORANDUM

To: All Agencies and Authorities That Receive State of Georgia General Obligation Bond Proceeds
From: Thurbert E. Baker, Attorney General

I am writing this memorandum to you to call your attention to certain responsibilities and obligations that agencies and authorities undertake when they request and receive State of Georgia General Obligation Bond proceeds. These responsibilities and obligations have a direct bearing on the tax-exempt status of the State’s bonds and must be given all needed attention.

When your agency is given a bond appropriation in the State’s general or supplemental budget, if your agency is governed by a board, that board adopts a resolution authorizing a request for issuance of general obligation debt by the Georgia State Financing and Investment Commission (“GSFIC”). Additionally, your agency usually sends a letter to GSFIC, transmitting any such adopted board resolution and requesting that the bonds authorized in the agency’s bond appropriation in the budget be issued. That resolution and that request letter both usually contain language similar to the following:

The Board has determined that it will not use the proceeds of the bonds or the projects or facilities financed therewith for any non-governmental purpose or any purpose constituting a private activity as defined under the Internal Revenue Code of 1986.

Any of the following arrangements with non-governmental entities for bond-funded facilities or projects may constitute a private business use, causing outstanding general obligation bonds to become “private activity bonds”:

- outright transfers of ownership;
- leases;
- management contracts;
- output contracts;
- research agreements; or
- any other arrangements that convey special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to those under any of the arrangements listed above.

Before your agency enters into any of the arrangements described above with respect to bond-funded projects or facilities, you should contact the Director of the Financing and Investment Division of GSFIC and the Department of Law and receive written confirmation that the proposed transaction will not endanger the tax-exempt status of outstanding State of Georgia General Obligation Bonds.
Research Opinions Date April 22, 2004 Authored by King and Spalding

The size of the Internal Revenue Code of 1986 makes it impossible to provide the document as an attachment. Therefore, you may utilize the online version of the Internal Revenue Code at the following web site:

http://www.fourmilab.ch/ustax/ustax.html
POLICY AND PROCEDURE OF THE GEORGIA STATE FINANCING AND INVESTMENT COMMISSION REGARDING NON-GOVERNMENTAL USE OF FACILITIES OWNED OR OPERATED BY DEPARTMENTS AND AGENCIES OF THE STATE OF GEORGIA, WHICH FACILITIES HAVE BEEN FINANCED IN WHOLE OR IN PART WITH THE PROCEEDS OF STATE OF GEORGIA TAX-EXEMPT GENERAL OBLIGATION BONDS

I. PURPOSE AND POLICY.

When the State of Georgia issues general obligation bonds, it has historically done so on a tax-exempt basis under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"). The issuance of general obligation bonds on a tax-exempt basis by the State allows the State to achieve the lowest possible interest cost since the interest on the bonds is excludable from the gross income of the purchasers of the bonds. In order to protect the tax-exemption of the State's general obligation bonds, compliance with covenants which the State makes in connection with the issuance of its general obligation bonds regarding the operation and use of the facilities by departments and agencies of the State financed in whole or in part with tax-exempt general obligation bond proceeds are of vital interest to the State.

II. PUBLIC/PRIVATE PARTNERSHIPS.

The Georgia State Financing and Investment Commission is aware that departments and agencies of the State in developing their capital financing plans often consider the operation or use of these facilities by non-governmental entities or persons in varying degrees. These are often referred to as public/private partnerships or privitization. The Georgia State Financing and Investment Commission has to be involved in the early planning process for such public/private partnerships in that to the extent such endeavors involve the use of State general obligation bond proceeds, there are certain limits imposed by the Internal Revenue Code which have to be met in order to protect the tax-exempt status of the interest on the State's general obligation bonds.

III. DIRECTIVE.

The Georgia State Financing and Investment Commission hereby directs that all departments and agencies of the State who are developing capital plans which may be financed, in whole or part, with the proceeds of State general obligation bond proceeds,
prior to the approval of any such capital plans by the department or agency or the execution of any contracts relating to such facilities by such department or agency, submit to the Director of the Construction Division of the Georgia State Financing and Investment Commission, the following:

(a) A statement of the type of project being considered;

(b) The nature of any operation or use by non-governmental entities or individuals;

(c) Any proposed leases and management or use contracts with non-governmental entities or individuals; and

(d) Any proposed research agreements with any non-governmental entities or individuals.

IV. GSFIC EVALUATION.

The Georgia State Financing and Investment Commission upon receipt of the information specified in Section III above will proceed as follows:

(a) The Construction Division of the Georgia State Financing and Investment Commission will identify whether there is any concern that needs to be addressed in order to protect the tax-exempt nature of the interest on State of Georgia general obligation bonds.

(b) The Construction Division of the Georgia State Financing and Investment Commission, with the advice and counsel of the Department of Law, will evaluate all leases, management or use contracts and research agreements to insure that they comply with the safe havens set forth in Internal Revenue Service Regulations and Revenue Procedures. Please see Exhibit A for an expanded discussion of current Internal Revenue Service provisions and safe havens. If the lease, management or use contract, or research agreement does not comply, the lease, management or use contract, or research agreement shall be modified to comply with Internal Revenue Service Regulations and Revenue Procedures prior to the department or agency's entering into any lease, management or use contract or research agreement with respect to facilities to be financed in whole or in part with the proceeds of State of Georgia tax-exempt general obligation bond proceeds.

V. ALLOCATION METHODS.

Sometimes the concern regarding the operation or use of the facilities in which State of Georgia tax-exempt general obligation bond proceeds are to be used can be addressed by an allocation of bond proceeds to the portions of the facilities which will have 100% governmental use only and with non-bond proceeds being used to finance the portions of the facilities which will be operated or used by non-governmental entities or
individuals. Exhibit A which sets forth certain current methods of allocation which are permissible under the Internal Revenue Code.

VI. RESERVATION OF 10% NON-QUALIFYING USE BY GSFIC ONLY.

Since facilities for many departments and agencies are often bundled together in a given series of State general obligation bonds, no department or agency shall decide on its own with its own advisors that any use by a non-governmental entity or person can be permitted because it is within the 10%, non-governmental use, exception, (sometimes called the "bad money" exception). The "bad money" exception is reserved solely to the Georgia State Financing and Investment Commission in that (a) only the Georgia State Financing and Investment Commission has knowledge of all of the facilities financed with the proceeds of any given bond issue and (b) the Georgia State Financing and Investment Commission hereby reserves such bad money portion to provide a safety factor in the event that facilities financed with the proceeds of State of Georgia general obligation bonds are used for unintended or non-permitted purposes contrary to the representations made by the department or agency when they receive such monies or to solve "change of use" of facilities which occur after the facilities are built. No State department or agency shall make capital plans depending upon a "bad money" analysis or enter into any contracts for any facilities in which the proceeds of State of Georgia tax-exempt bond proceeds are to be used depending upon any such "bad money" analysis without the specific written approval of the Director or the Construction Division of the Georgia State Financing and Investment Commission.

VII. REMEDIAL ACTION.

If after all of the safe guards above set forth are utilized and in order to protect the tax-exemption of outstanding State of Georgia general obligation bonds, the Georgia State Financing and Investment Commission determines that any departmental or agency has failed to use bond proceeds in accordance with the representations set forth in its request resolution for tax-exempt State of Georgia general obligation bond proceeds, the Department of Law shall be requested to enforce such representations and covenants in order to protect the tax-exempt status of the State's general obligation bonds.