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ISSUE BRIEF

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CERTIFICATES OF PARTICIPATION

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In lieu of issuing bonds, or using another form of long-term debt, the state often uses a form of lease-purchase agreement called certificates of participation (COPs) to finance the construction of its new facilities. A certificate refers to an investor's proportionate interest in the state's lease payments. COPs give the state the flexibility to build capital facilities even when funds are not available to pay for projects on a pay-as-you-go basis. The Colorado Supreme Court has ruled on two occasions in the last few decades that COPs are not considered a form of long-term debt and thus do not require prior voter approval before issuance. This issue brief explains how COPs work, discusses the historic use of COPs, summarizes the required legislative review, and outlines outstanding issuances.

How COPs work. Once authority for a COP issuance is obtained from the legislature, the state enters into a lease-purchase agreement for a proposed facility. Typically in COP financing, the state transfers its interests in a property to a lessor and then leases the property back through annual lease payments. The lessor assigns its interests to a trustee — usually a commercial bank — who holds title to the property, collects lease payments from the state, and makes payments to the investors.

The state makes annual payments authorized through the annual budget bill (Long Bill) that include both principal and interest. The interest rate paid by the state is fixed and depends on market conditions at the time COPs are priced for sale. The state renews the lease each year through an appropriation in the Long Bill. When the lease ends, the state owns the facility at no or minimal additional cost. If the state fails to make the annual lease payment, the lease terminates and the trustee may sell, re-let, or otherwise dispose of the property, using the proceeds to pay the investors. Also, the state can decide at any time to terminate the lease and payments. If the state so chooses, by not appropriating funds for the project, it would forfeit the leased property to the investors, and it would not be obligated to repay any remaining costs.

Historic use of COPs. The state has been issuing COPs to finance capital projects for more than 35 years. In 1979, the state issued a series of COPs to finance the construction of several regional facilities for the developmentally disabled. In 1983, the state was sued over the constitutionality of lease-purchase financing in *Glennon Heights, Inc. vs. Central Bank & Trust, 658 P.2d (Colo 1983)*. The case centered on the construction of two group homes financed through the 1979 sale of COPs. The plaintiffs in the case claimed that the use of a lease-purchase agreement to finance the projects was an illegal debt contracted by the state in violation of Article XI, Section 3, of the Colorado Constitution. The Colorado Supreme Court found that the use of a lease-purchase agreement, in this case through the issuance of COPs, did not violate the constitution.

Between 1979 and 2002, the state issued eight additional COPs. The proceeds from the sale of these COPs were used for the construction of several Division of Youth Corrections facilities, state prisons, a state office building, and several classroom facilities. Most of the COPs issued between 1979 and 2002 were repaid from proceeds from the statewide lottery.

In 2005, COPs were issued on behalf of two projects. House Bill 03-1256 authorized the sale of COPs on behalf of a new prison and for seven classroom facilities on the University of Colorado at Denver Anschutz Medical Campus. However, the projects were delayed by a new legal challenge to the use of COPs in *Colorado Criminal Justice Reform Coalition v. Ortiz, 121 P3d. 288 (Colo App. 2005)*. The plaintiffs in the case claimed that the proposed COPs would create a multi-year fiscal obligation within the meaning of TABOR, thus violating the constitutional requirement for prior voter approval. The Colorado Court of Appeals ruled that the use of COPs does not violate the constitution, and concluded that "lease-purchase agreements for buildings or other improvements in which the parties are not bound to renew the lease annually do not create a debt or other financial obligation in the constitutional sense."

Review requirements. State law requires that, before a lease-purchase agreement costing more than $500,000 over the term of the agreement can be executed, it must be specifically authorized by a bill other than the Long Bill or a supplemental budget bill.[1] Legislative authorization is required for both proposed COP issuances and for the more traditional form of lease-purchase where one rents-to-own an existing building or property.

Legislative authorization is also required for annual lease payments. Lease payments must be annually appropriated in the operating or capital budget. Lease agreements are renewed each year through the Long Bill appropriations process.

[1] Section 24-82-801 (1)(b), C.R.S.

Outstanding COP issuances. The state is currently making payments for seven COP issuances on behalf of buildings constructed to serve various state functions.[2] Outstanding COP issuances on behalf of these facilities are outlined below.

Table 1. Outstanding COP Issuances

Project	Average Annual Payment	Last Year of Lease Term
Anschutz Medical Campus, University of Colorado at Denver	$12.7 million*	FY 30-31
Centennial Correctional Facility, Department of Corrections	$16.6 million	FY 18-19
Colorado History Museum and Ralph Carr Justice Center, History Colorado and the Judicial Department	$21.6 million*	FY 45-46
Grand Junction Laboratory, Colorado Bureau of Investigation**	$0.7 million	FY 32-33
Office Consolidation, Department of Agriculture	$0.4 million*	FY 33-34
Pueblo West Laboratory, Colorado Bureau of Investigation	$0.7 million	FY 33-34
Various Higher Education Facilities (12)	$16.9 million*	FY 27-28
Total Average Annual Payment Amount	**$69.6 million***	

*Payments made, in whole or part, from cash fund sources.
**Pending COP refinance. Sale is scheduled for fall 2015.

House Bill 15-1344 authorizes the State Treasurer to issue COPs in an amount of $250 million, plus reasonable administrative expenses, on or after July 1, 2019, on behalf of Colorado State University to construct several facilities at the National Western Center and on the university campus. Additional legislative review is required prior to issuance.

[2] A separate issue brief details COPs issued on behalf of K-12 facilities through the Building Excellent Schools Today (BEST) Program. See: http://tinyurl.com/qc2qfbl