



Montana Legislative Services Division
Legal Services Office

To: Legislative Finance Committee
From: Julie Johnson, LFC Staff Attorney
Re: Legal Considerations for Funding Concepts
Date: September 5, 2018

I have been asked to address legal considerations regarding three financial concepts for state building projects: (1) Pay-As-You Go; (2) Lease-To-Own; and (3) Public Authority Bonding. As the first concept is simply a matter of using cash to build state buildings, no specific legal analysis is warranted. Legal considerations regarding the Lease-To-Own concept were addressed in a memo presented to the LFC at its May 2018 meeting, and is briefly discussed below. Accordingly, most of this memo is dedicated to the third concept of Public Authority Bonding.

I. Pay-As-You-Go

- increase funding to long-range building program account or establish another dedicated revenue source and state special revenue account (15-35-108)

II. Lease-To-Own

- amend 18-3-101 to allow for lease to own with a majority vote
- use of non-appropriation clause and lease appropriations made in HB 2
- unsettled question of law but valid argument to be made lease-to-own contract is not stated debt as long as is contain a non-appropriation clause
- lessor may have other remedies if lease payments are not appropriated

III. Public Authority Bonding

A. Background on Public Authorities¹

Public authorities have been operating in the United States since the 19th century when, after a series of cyclical depressions, states adopted constitutional restrictions on the borrowing powers of their legislatures and the use of state credit. Beginning with the early canal companies, public authorities, also known as public-benefit authorities or revenue authorities, were designed to address constitutional restrictions by borrowing outside the purview of state responsibility. The use of public authorities expanded dramatically in the 1930s with housing and transportation authorities, which borrowed without the backing of state funds to deliver the governmental services.

Here, the proposed concept is that the State of Montana would form a public-benefit corporation (perhaps known as the State Building Authority), which could possibly be housed with the Facility Finance Authority. The State Building Authority, with the assistance of the Board of

¹ Paraphrased from Robert Lamb & Stephen P. Rappaport, *Municipal Bonds* 78-79 (McGraw-Hill, Inc. 1980).

Investments, would issue revenue bonds to finance the construction of buildings that state agencies would in turn lease from the Authority. The Authority would use the lease proceeds to pay on the debt service for the bonds. Leases with state agencies could be either perpetual or on a lease-to-own basis.

B. Example of a State Building Authority

1. Outline of the Michigan State Building Authority Act

Michigan passed the State Building Authority Act in 1964 which created the State Building Authority.² The Building Authority is run by a board of 5 members, all of whom are appointed by the Governor. Like Montana, the Michigan Constitution requires a two-thirds vote to allow the state to borrow money.³ However, Michigan's Constitution also requires that the question be submitted to the electorate at the next general election.⁴ Consequently, the threshold for the approval of state debt in Michigan is significantly more challenging.

The title of the Michigan act itself best summarizes what authority and duties are granted to the State Building Authority:

AN ACT creating the state building authority with power to acquire, construct, furnish, equip, own, improve, enlarge, operate, mortgage, and maintain facilities for the use of the state or any of its agencies; to act as a developer or co-owner of facilities as a condominium project for the use of the state or any of its agencies; to authorize the execution of leases pertaining to those facilities by the building authority with the state or any of its agencies; to authorize the payment of true rentals by the state; to provide for the issuance of revenue obligations by the building authority to be paid from the true rentals to be paid by the state and other resources and security provided for and pledged by the building authority; to authorize the creation of funds; to authorize the conveyance of lands by the state or any of its agencies for the purposes authorized in this act; to authorize the appointment of a trustee for bondholders; to permit remedies for the benefit of parties in interest; to provide for other powers and duties of the authority; and to provide for other matters in relation to the authority and its obligations.

² Act 183 of 1964, codified at Mich. Comp. Laws §§ 830.411 through 830.425.

³ Mont Const., Art. 8, sec. 8; Mich. Const. Art. IX, sec. 15.

⁴ Mich. Const. Art. IX, sec. 15 provides: "The question submitted to the electors shall state the amount to be borrowed, the specific purpose to which the funds shall be devoted, and the method of repayment."

The basic framework of the legislation creating the State Building Authority in Michigan is as follows:

- Definitions.
- Legislative findings.
- State building authority; creation; body corporate; powers; handling of funds; board of trustees (5 on the board); appointment and terms of members; vacancy; oath; organization; conducting business at public meeting; notice; quorum; action of board.
- Powers of building authority generally.
- Acquisition of property; condemnation.
- Conveyance to building authority of property owned by state or institution of higher education.
- Lease of facilities to state; term; provisions.
- Lease of facilities from authority; approval; payment of true rental; leasing of furnishings or equipment; lease for capital maintenance improvements.
- Revenue obligations generally.
- Reserve fund; creation; purpose; use of income and interest.
- Obligations; statutory first lien; enforcement.
- Moneys of building authority; contract with bondholders; security for deposits.
- Indebtedness of state.⁵
- Exemption from taxation.
- Liability on notes or bonds.
- Investment in bonds.
- Declaration of public purpose; liberal construction.
- Act supplemental and additional to existing powers.
- Advisory opinion as to constitutionality.⁶

2. Michigan Supreme Court Advisory Opinion as to Constitutionality

As requested, the Michigan Supreme Court issued an advisory opinion on the

⁵ This section provides: "This act shall not be construed or interpreted as to authorize or permit the incurring of indebtedness of the state contrary to the provisions of the state constitution." Mich. Comp. Laws § 830.420.

⁶ The Michigan Constitution allows its legislature to "request the opinion of the supreme court on important questions of law upon solemn occasions as to the constitutionality of legislation after it has been enacted into law but before its effective date." (Mich. Const. Art. III, sec. 8). The Michigan Supreme Court ultimately concluded that the Act was constitutional, holding that the obligation to pay rent under a lease did not involve borrowing.

constitutionality of the State Building Authority Act, in which it held the act was constitutional⁷:

The obligation to pay rent under a lease does not involve borrowing. Consequently it does not result in the incurring of a debt as that word is used in limitations thereon. Accordingly we are of the opinion that neither § 12 nor § 15 of Const 1963, art 9, precludes the state from leasing property under the provisions of The Act.

If under The Act the state may lease property from the State Building Authority, are future Legislatures contractually obligated to appropriate amounts each year sufficient to pay periodic rentals to the building authority for true rent falling due in future years? We answer in the affirmative.

Would the bonds to be issued pursuant to The Act by the building authority and repaid from proceeds derived from true rental payments by the state pursuant to lease constitute a state indebtedness within the meaning of §§ 12 and 15 of Const 1963, art 9? We answer in the negative. Only general obligation bonds are limited by §§ 12 and 15. Revenue bonds and special obligation bonds are not within the ban of these sections.

We do not regard the bonds contemplated by The Act as pledging the general obligation of the state to their repayment. They purport to be revenue bonds, payable only from the revenue generated by the payment of "true rental" under the terms of the lease. No undertaking on the part of the state to pay the bonds is authorized and a disclaimer of a pledge of the state's general obligation is required under § 8 of The Act.

We do not regard the contractual obligation of the state to make lease payments as a promise to pay the bonds. The nature of these bonds as true revenue bonds is not vitiated by the circumstance that the state's rental obligation will be paid from the general tax fund. We have regarded revenue bonds as exempt from the constitutional borrowing limitations not because state tax funds would never provide their repayment but rather because revenue bonds are secured and repaid by the users of the project financed.

The dissent, however, disagreed, and concluded that the Act violated the Michigan Constitution⁸:

While § 2 of the Act declares that the authority is "a body corporate, separate and

⁷ In re Request for Advisory Opinion Enrolled Senate Bill, 254 N.W.2d 544, 547-548 (1977). (Citations omitted).

⁸ *Dissent, Id.*, 254 N.W.2d at 551-552.

distinct from the state", it is our duty to cut through form and examine the substance of the relationship. That duty is especially important when a transaction may be in violation of the Constitution.

Piercing through the formalisms of the Act reveals that in fact the sole purpose of the authority is to serve the government's building needs and in substance it acts as an agent of the government, assigned to acquire space by issuing bonds. Thus the authority's debt is in reality the state's debt.

Even if one were to accept the formal recitations in the Act and consider the authority an independent entity, the Act must still be deemed an unconstitutional borrowing by the state. The legislation creates an illusory entity in an attempt to divorce "the borrowing function from the paying function in what is essentially one integral transaction." The essential function of the authority is to borrow money. The authority itself has no use for the buildings it will acquire; they are solely for use by the state.

It is my opinion that it is the manifest intent and effect of this Act to evade constitutional limitations on debt. Because the legislation is an attempt to commit the power to tax the people of the State of Michigan to pay off a long-term debt without their direct approval, I conclude that it is unconstitutional.

C. Considerations on Pursuing the Public Authority Concept

Should the Legislative Finance Committee want to further pursue the Public Authority Bonding concept, further discussions with public benefit corporations could be helpful to understand how these authorities function and what advantages and drawbacks they offer.

At the end of the day, the question to be resolved is whether the types of bonds a public authority would issue qualify as state debt under the Montana Constitution. If so, then any legislation approving a public authority would require a two-thirds vote.⁹ However, courts in other states, such as the Supreme Court Michigan, have concluded that revenue bonds paid by lease payments from state agencies to a state building authority are not state debt, in which case, legislation would require a simple majority.

⁹ Montana already has two provisions in code, 17-5-720 and 17-5-721, MCA, which provide authority to issue revenue bonds to finance renewable resource projects approved by the legislature and expressly state that "[r]evenue bonds issued pursuant to this section without the pledge of the coal severance tax to the payment of the bonds are not coal severance tax bonds or a state debt."

